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# THE GENERAL STATUTES OF NORTH CAROLINA

Containing General Laws of North Carolina through  
the Legislative Session of 1965

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PREPARED UNDER THE SUPERVISION OF THE DEPARTMENT OF JUSTICE  
OF THE STATE OF NORTH CAROLINA

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Annotated, under the Supervision of the Department of Justice,  
by the Editorial Staff of the Publishers

*Under the Direction of*

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AND J. P. MUNGER

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Volume 1D

1965 REPLACEMENT VOLUME

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THE MICHIE COMPANY, LAW PUBLISHERS  
CHARLOTTESVILLE, VA.  
1965

# THE GENERAL STATUTES OF NORTH CAROLINA

Consolidated and Revised  
by the Legislative Council in 1909

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Volume 11

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THE MICHIE COMPANY  
1000 NORTH CAROLINA AVENUE  
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# Scope of Volume

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## Statutes:

Full text of Chapters 21 through 27 of the General Statutes of North Carolina, including all enactments through the Legislative Session of 1965 heretofore contained in 1953 Recompiled Volume 1C of the General Statutes and the 1965 Cumulative Supplement thereto.

## Annotations:

Sources of the annotations to the General Statutes appearing in this volume are:

North Carolina Reports volumes 1-265 (p. 217).  
Federal Reporter volumes 1-300.  
Federal Reporter 2nd Series volumes 1-347 (p. 320).  
Federal Supplement volumes 1-242 (p. 512).  
United States Reports volumes 1-381 (p. 531).  
Supreme Court Reporter volumes 1-85.  
North Carolina Law Review volumes 1-43 (p. 665).

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# Abbreviations

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(The abbreviations below are those found in the General Statutes which refer to prior codes.)

P. R. .... Potter's Revisal (1821, 1827)  
R. S. .... Revised Statutes (1837)  
R. C. .... Revised Code (1854)  
C. C. P. .... Code of Civil Procedure (1868)  
Code .... Code (1883)  
Rev. .... Revisal of 1905  
C. S. .... Consolidated Statutes (1919, 1924)





# Preface

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Volume 1 of the General Statutes of North Carolina of 1943 was replaced in 1953 by recompiled volumes 1A, 1B and 1C, containing Chapters 1 through 27 of the General Statutes, as amended and supplemented by the enactments of the General Assembly down through the 1951 Session. Recompiled volume 1C has now been replaced by replacement volumes 1C and 1D, which combine the statutes and annotations appearing in the previous volume 1C and in the 1965 Cumulative Supplement thereto.

Volume 1C contains Chapters 15 through 20. Volume 1D contains Chapters 21 through 27.

In replacement volume 1D the form and the designations of subsections, subdivisions and lesser divisions of sections have in many instances been changed, so as to follow in every case the uniform system of numbering, lettering and indentation adopted by the General Statutes Commission. For example, subsections in the replacement volume are designated by lower case letters in parentheses, thus: (a). Subdivisions of both sections and subsections are designated by Arabic numerals in parentheses, thus: (1). Lesser divisions likewise follow a uniform plan.

The historical references appearing at the end of each section have been rearranged in chronological order. For instance, the historical references appended to § 31-5.1 read as follows: (1784, c. 204, s. 14; 1819, c. 1004, ss. 1, 2; 1840, c. 62; R. C., c. 119, s. 22; Code, s. 2176; Rev., s. 3115; C. S., s. 4133; 1945, c. 140; 1953, c. 1098, s. 3.) In this connection attention should be called to a peculiarity in the manner of citing the early acts in the historical references. The acts through the year 1825 are cited, not by the chapter numbers of the session laws of the particular years, but by the chapter numbers assigned to them in Potter's Revisal (published in 1821 and containing the acts from 1715 through 1820) or in Potter's Revisal continued (published in 1827 and containing the acts from 1821 through 1825). Thus, in the illustration set out above the citations "1784, c. 204, s. 14; 1819, c. 1004, ss. 1, 2" refer to the chapter numbers in Potter's Revisal and not to the chapter numbers of the Laws of 1784 and 1819, respectively. The chapter numbers in Potter's Revisal and Potter's Revisal continued run consecutively, and hence do not correspond, at least after 1715, to the chapter numbers in the session laws of the particular years. After 1825 the chapter numbers in the session laws are used.

This replacement volume has been prepared and published under the supervision of the Department of Justice of the State of North Carolina. The members of the North Carolina Bar are requested to communicate any defects they may find in the General Statutes, and any suggestions they may have for improving them, to the Department, or to The Michie Company, Law Publishers, Charlottesville, Virginia.

THOMAS WADE BRUTON,  
*Attorney General.*

*December 1, 1965.*





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## Chapter 21.

### Bills of Lading.

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#### ARTICLE 1.

##### *Definitions.*

§§ 21-1 to 21-3: Repealed by Session Laws 1965, c. 700, s. 2, effective at midnight June 30, 1967.

**Editor's Note.**—For provisions of the lading and other documents of title, see Uniform Commercial Code as to bills of §§ 25-7-101 to 25-7-603.

#### ARTICLE 2.

##### *Issue of Bills of Lading.*

§§ 21-4 to 21-8: Repealed by Session Laws 1965, c. 700, s. 2, effective at midnight June 30, 1967.

#### ARTICLE 3.

##### *Obligations and Rights of Carriers upon Bills of Lading.*

§§ 21-9 to 21-27: Repealed by Session Laws 1965, c. 700, s. 2, effective at midnight June 30, 1967.

#### ARTICLE 4.

##### *Negotiation and Transfer of Bills.*

§§ 21-28 to 21-41: Repealed by Session Laws 1965, c. 700, s. 2, effective at midnight June 30, 1967.

#### ARTICLE 5.

##### *Criminal Offenses.*

§ 21-42. **Issuing false bills or violating chapter made felony.**—Any person who, knowingly or with intent to defraud, falsely makes, alters, forges, counterfeits, prints or photographs any bill of lading purporting to represent goods received for shipment in this State, or with intent utters or publishes as true and genuine any such falsely altered, forged, counterfeited, falsely printed or photographed bill of lading, knowing it to be falsely altered, forged, counterfeited, falsely printed or photographed, or aids in making, altering, forging, counterfeiting, printing, or photographing, or uttering or publishing the same, or issues or aids in issuing or procuring the issue of, or negotiates or transfers for value a bill which contains a false statement as to the receipt of the goods, or as to any other matter, or who, with intent to defraud, violates or fails to comply with, or aids in any violation of, or failure to comply with any provision of this chapter, shall be guilty of a felony and, upon conviction, shall be punished for each offense by imprisonment not exceeding five years, or by a fine not exceeding five thousand dollars, or both. (1919, c. 65, s. 41; c. 290; C. S., s. 323.)



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**§ 22-1. Contracts charging representative personally; promise to answer for debt of another.**—No action shall be brought whereby to charge an executor, administrator or collector upon a special promise to answer damages out of his own estate or to charge any defendant upon a special promise to answer the debt, default or miscarriage of another person, unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party charged therewith or some other person thereunto by him lawfully authorized. (29 Charles II, c. 3, s. 4; 1826, c. 10; R. C., c. 50, s. 15; Code, s. 1552; Rev., s. 974; C. S., s. 987.)

I. In General.

II. Promise of Representative to Answer from Own Estate.

III. Promise to Answer for Debt of Another.

A. In General.

B. Illustrative Cases.

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#### I. IN GENERAL.

**Editor's Note.**—This and the following sections of this chapter are generally known as the "statute of frauds," and are based upon the original English "Act for the Prevention of Frauds and Perjuries." As the name indicates, its object was to prevent fraud and perjury; and it was designated by Lord Campbell as the most important piece of judicial legislation of which England can boast. In modern usage the term "statute of frauds" has assumed an exclusive meaning as to the necessity for certain contracts to be in writing. See 13 N.C.L. Rev. 263 for comment on this section.

The purpose of the statute of frauds is

to prevent fraud upon individuals charged with participation in transactions coming within its purview, and not upon the public at large. *Allison v. Steele*, 220 N.C. 318, 17 S.E.2d 339 (1941).

**Construction Taking Cases Out of Statute Should Not Be Extended.**—The relaxing construction of the statute of frauds under which so many cases have been taken out of its operation, which seem to be within its letter, ought not to be extended further than it has already been carried. *Grant v. Naylor*, 8 U.S. (4 Cranch) 224, 2 L. Ed. 603 (1808).

**Definiteness of Subject Matter of Contract.**—The principle that no contract can be enforced unless the subject matter upon which it is intended by the parties to operate can first be definitely ascertained from its terms, either through an explicit description therein or a reference which points to extrinsic means of identification applies to verbal agreements as well as to those required by this section to be in writing. *Hemphill v. Annis*, 119 N.C. 514, 26 S.E. 152 (1896).

**Cited in** *Coxe v. Dillard*, 197 N.C. 344, 148 S.E. 545 (1929); *Newburn v. Fisher*, 198 N.C. 385, 151 S.E. 875 (1930); *Strayhorn v. Aycock*, 215 N.C. 43, 200 S.E. 912 (1939); *General Tire & Rubber Co. v. Distribs., Inc.*, 253 N.C. 459, 117 S.E.2d 479 (1960); *Baker v. Malan Constr. Corp.*, 255 N.C. 302, 121 S.E.2d 731 (1961).

#### II. PROMISE OF REPRESENTATIVE TO ANSWER FROM OWN ESTATE.

**Oral Promise by Representative Is Void.**—A promise by the administrator that he would see that a debt of his intes-

tate is paid, or that he would pay it, is void under this section, unless made in writing. *Smithwick v. Shepherd*, 49 N.C. 196 (1856).

**If It Is to Pay Out of His Estate.**—The agreement, in order not to be enforceable unless in writing, must be to pay out of the representative's own estate. *Norton v. Edwards*, 66 N.C. 367 (1872).

### III. PROMISE TO ANSWER FOR DEBT OF ANOTHER.

#### A. In General.

**Section Is Not Applicable to Action on Parol Trust.**—The portion of this section providing in substance that an action on a promise to pay the debt of another may not be maintained unless the agreement upon which it is based shall be in writing, and signed by the party charged, or by some other person lawfully authorized, is not applicable to an action on a parol trust. *Cuthrell v. Greene*, 229 N.C. 475, 50 S.E.2d 525 (1948).

Plaintiff alleged that her employer changed the beneficiary in a policy of insurance on his life to another employee under an agreement, understood, discussed and acquiesced in by all parties, that upon his death such other employee would pay out of the proceeds of such insurance the balance due on a mortgage on plaintiff's home, and thus recompense both employees for services faithfully rendered. It was held that the action was one to establish a parol trust and not one to recover on a promise by the employer to answer for the debt of plaintiff, and therefore this section had no application. *Cuthrell v. Greene*, 229 N.C. 475, 50 S.E.2d 525 (1948).

**Or to Promise Creating Original Obligation.**—The clause relating to promise to answer for the debt, default, miscarriage, etc., of another does not apply to a promise in respect to debts created at the instance and for the benefit of the promisor. But it applies only to those by which the debt of one party is sought to be charged upon and collected from another. *Davis v. Patrick*, 141 U.S. 479, 12 Sup. Ct. 58, 35 L. Ed. 826 (1891).

This section does not apply where it is in the nature of an original promise. *Hickory Novelty Co. v. Andrews*, 188 N.C. 59, 123 S.E. 314 (1924). See *Sharp v. Tatham*, 205 N.C. 827, 170 S.E. 654 (1933); *Gennett v. Lyerly*, 207 N.C. 201, 176 S.E. 275 (1934).

Whenever the main purpose and object of the promisor is not to answer for another, but to subserve some pecuniary or business

purpose of his own, involving either a benefit to himself or damage to the other contracting party, his promise is not within the statute, although it may be in form a promise to pay the debt of another, and although the performance of it may incidentally have the effect of extinguishing that liability. *Warren v. White*, 251 N.C. 729, 112 S.E.2d 522 (1960).

Where the promise is for the benefit of the promisor, and he has a personal, immediate, and pecuniary benefit in the transaction, or where the promise to pay the debt of another is all or part of the consideration for property conveyed to the promisor, or is a promise to make good notes transferred in payment of property, the promise is valid although in parol. If, however, the promise does not create an original obligation, and it is collateral, and is merely superadded to the promise of another to pay the debt, he remaining liable, the promisor is not liable, unless there is a writing; and this is true whether the promise is made at the time the debt is created or not. *Myers v. Allsbrook*, 229 N.C. 786, 51 S.E.2d 629 (1949).

An agreement by a mortgage company with a lumber dealer to pay for lumber to be used in the construction of a building on the mortgaged premises is an original promise which does not come within the purview of the statute of frauds and parol evidence of such agreement is competent. *Pegram-West v. Winston Mut. Life Ins. Co.*, 231 N.C. 277, 56 S.E.2d 607 (1949).

The following illustrates when a promise comes within the provisions of this section. If, for instance, two persons come into a store and one buys and the other, to gain him credit, promises the seller, "If he does not pay you, I will," this is a collateral undertaking and must be in writing; but if he says, "Let him have the goods and I will pay," or "I will see you paid," and credit is given to him alone, he is himself the buyer, and the undertaking is original. *Goldsmith v. Erwin*, 183 F.2d 432 (4th Cir. 1950).

**As Where the Other Does Not Remain Liable.**—The general rule is that a promise to answer for the debt, default or miscarriage of another for which that other remains liable, must be in writing to satisfy this section. It is otherwise when the other does not remain liable. *Mason v. Wilson*, 84 N.C. 51 (1881).

In order for the defendant to fall within the protection of the statute, it must be shown that the debt is that of a third person who still continues liable for the same. If the debt is an original obligation of the

defendant, or if the creditor in accepting the promise of the defendant has released a third person who was the original debtor, the statute has no application. *Sheppard v. Newton*, 139 N.C. 533, 52 S.E. 143 (1905).

The statute does not forbid an oral contract to assume the debt of another who is thereupon discharged of all liability to the creditor, the promisor becoming sole debtor in his stead. *Jenkins v. Holley*, 140 N.C. 379, 53 S.E. 237 (1906).

**What Determines Nature of Promise as Original or Collateral.**—Whether a promise is an original one not coming within the provisions of this section, or a superadded one barred by the statute, does not depend altogether on the form of expression, but the situation of the parties, and whether they understood the promise to be direct or collateral, should also be considered. *Dozier v. Wood*, 208 N.C. 414, 181 S.E. 336 (1935).

Whether a promise is an original one not coming within the statute of frauds, or a collateral one required by this section to be in writing, is to be determined from the circumstances of its making, the situation of the parties, and the objects sought to be accomplished. *Goldsmith v. Erwin*, 183 F.2d 432 (4th Cir. 1950).

The question always is what the parties mutually understood by the language, whether they understood it to be collateral or a direct promise. *Davis v. Patrick*, 141 U.S. 479, 12 Sup. Ct. 58, 35 L. Ed. 826 (1891).

A promise is an original promise not coming within the statute of frauds if the extension of credit is made to the promisor or if the contract is made for the benefit of the promisor; but if the contract is made with the third person and the promise constitutes a separate and independent contract under which the promisor agrees to pay upon default of the primary debtor, the promise is a collateral agreement and comes within the statute. *Balentine v. Gill*, 218 N.C. 496, 11 S. E. 2d 456 (1940).

Where there is no benefit to the one promising to answer for the debt of another, and the promise does not create an original obligation, but is a collateral promise, merely superadded to the promise of another, the original promisor remaining liable, the collateral promisor is not liable unless there is a writing, whether the promise is made when the debt is created or not. *Sheppard v. Newton*, 139 N.C. 533, 52 S.E. 143 (1905); *Peele v. Powell*, 156 N.C. 553, 73 S.E. 234 (1911).

Where the promisor says to the creditor "collect from him (the debtor) and if he fails to pay, I will," the undertaking is a collateral one, and not enforceable unless in writing. *Garrett Co. v. Hamill*, 131 N.C. 57, 42 S.E. 448 (1902).

A promise made at the time or before the debt is created, and where credit is given solely to the promisor, or a promise based on a new consideration between the promisor and the creditor, or a promise for the benefit of the promisor where he has a personal and pecuniary interest in the transaction in which a third party is the original obligor, has been held to be an original promise. *Whitehurst v. Padgett*, 157 N.C. 424, 73 S.E. 240 (1911); *Warren v. White*, 251 N.C. 729, 112 S.E. 2d 522 (1960).

Similarly, a direct and unconditional promise by one to pay for goods furnished to a third party, made prior to the delivery of the goods, upon the faith of which the goods are delivered is an original undertaking. *Morrison v. Baker*, 81 N.C. 76 (1879); *Garrett Co. v. Hamill*, 131 N.C. 57, 42 S.E. 448 (1902).

In *Hanes Funeral Home v. Spencer*, 214 N.C. 702, 200 S.E. 397 (1939), evidence was held ample to support finding that undertaking by defendant's ward to pay expenses for the funeral of the wife of a close friend was an original promise not coming within the purview of this section.

**How Intent of Promisor Determined.**—The intent of the promisor to become bound may be shown by the surrounding circumstances and other transactions or written communications between the creditor and the promisor. *Hickory Novelty Co. v. Andrews*, 188 N.C. 59, 123 S. E. 314 (1924).

Anything which shows the intention or the actual contract of the parties is material, and any evidence which goes to show the real intention of the parties is admissible whether it be by way of conduct or documentary in nature in order to determine whether a promise is an original one not coming within the provisions of this section, or a superadded one barred by this section. *Goldsmith v. Erwin*, 183 F.2d 432 (4th Cir. 1950).

**Effect of New Consideration.**—Where the party promising to pay a debt receives a new and original consideration from the debtor for his promise, this section does not apply. *Daniels v. Duck Island, Inc.*, 212 N.C. 90, 193 S.E. 7 (1937). See *Cooper v. Chambers*, 15 N.C. 261 (1833); *Mason v. Wilson*, 84 N. C. 51 (1881); *Whitehurst v. Hyman*, 90 N.C.



487 (1884); *Peele v. Powell*, 156 N.C. 553, 73 S.E. 234 (1911); *Hasty Mercantile Co. v. Bryant*, 186 N.C. 551, 120 S.E. 200 (1923); *Taylor v. Lee*, 187 N.C. 393, 121 S.E. 659 (1924); *Hickory Novelty Co. v. Andrews*, 188 N.C. 59, 123 S.E. 314 (1924). And this is true even where the benefit of the consideration for the promise accrues to a person other than the promisor. *Gainesville & Alachua Hosp. Ass'n v. Hobbs*, 153 N.C. 188, 69 S.E. 79 (1910). But see *Stanly v. Hendricks*, 35 N.C. 86 (1851); *Threadgill v. McLendon*, 76 N.C. 24 (1877), where it is said that a new consideration does not take the promise out of the operation of the statute.

The mere fact that there may be a new consideration for the oral promise of a defendant to pay the subsisting debt of another is not sufficient of itself to take the promise out of the prohibition of the statute of frauds. To say that any consideration will take a promise based thereon out of the statute is to make the statute useless. For if there is no consideration the promise is invalid without the statute. The statute is aimed at what were valid contracts; that is to say, it makes invalid contracts not in writing which would otherwise have been valid. *Myers v. Allsbrook*, 229 N.C. 786, 51 S.E.2d 629 (1949).

**Statement of Consideration Need Not Be Written.**—Under this section, the consideration for a promise to answer need not be contained in the writing. *Green v. Thornton*, 49 N.C. 230 (1856); *Standard Supply Co. v. Person*, 154 N.C. 456, 70 S.E. 745 (1911).

**Paper Writing Not Supporting Action.**—A paper writing signed by defendant stated that he owed a certain sum to a named person and contained the words "I agree to Ed Deaton [plaintiff] \$1000 of this amount when I pay off." It was held that the paper writing was incomplete and uncertain in meaning and was not a written special promise to answer the debt of another so as to enable plaintiff to maintain an action on it. *Deaton v. Coble*, 245 N.C. 190, 95 S.E.2d 569 (1956).

**Facts Showing Promise within Statute.**—The evidence was to the effect that a check given by an automobile retailer to plaintiff in payment of a car was returned unpaid, that plaintiff went to the debtor's place of business and that defendant, who was the debtor's brother, and who was handling the business during debtor's illness, told plaintiff to redeposit the check in about two weeks and that if it were not then paid by the bank he would send plaintiff a cashier's check for part and a

personal check for the balance. It was alleged that after the debtor's death the defendant and two others purchased the business, but it was not alleged that at the time of the promise defendant contemplated purchasing the business or any interest therein. Held: While the evidence is sufficient to justify a finding that defendant personally promised to pay the check if his brother's funds were insufficient, and plaintiff's forbearance to take any action on the check for a period of two weeks was sufficient consideration for the promise, there is no allegation that the defendant made the promise to obtain any personal advantage from such forbearance, and therefore the promise comes within the statute of frauds, and defendant's motion to nonsuit was properly allowed. *Myers v. Allsbrook*, 229 N.C. 786, 51 S.E.2d 629 (1949).

**Question for Jury as to Whether Original Promise Covered Second Transaction.**—Where evidence tended to show that defendants ordered two or three cars of lumber, both defendants being present and promising to be personally responsible therefor, and after the first car was shipped, one of defendants went to plaintiff and told him to ship another car under the same arrangements, it was sufficient to be submitted to the jury on the question whether the original promise of both defendants, made when both were present, covered the second car as well as the first. *Brown v. Benton*, 209 N.C. 285, 183 S.E. 292 (1936).

#### B. Illustrative Cases.

**Promise to Pay Out of Money Placed in Hands of Promisor by Debtor.**—While the statute of frauds does not apply to an oral promise to pay the debt of another out of money or property which the debtor has placed in the hands of the promisor for the purpose of paying the debt, evidence tending to show that the debtor entrusted certain funds to the promisor for the purpose of carrying on the debtor's business, without evidence that he entrusted the funds for the specific purpose of paying debtor's debts, is insufficient to bring the promise within this rule. *Myers v. Allsbrook*, 229 N.C. 786, 51 S.E.2d 629 (1949).

Where purchaser orally agrees in consideration of conveyance to him of property to pay certain debts of his vendor due to a third person, the promise is original and not within the statute. *Rice v. Carter*, 33 N.C. 298 (1850); *Stanly v. Hendricks*, 35 N.C. 86 (1851).

**Parol Assumption of Mortgage Debt.**—A promise by a grantee of mortgaged land to assume and pay the amount of the mortgage is not a promise to pay the debt of another required by this section to be in writing, but is a direct obligation of the grantee supported by sufficient consideration. *Parlier v. Miller*, 186 N.C. 501, 119 S.E. 898 (1923).

**Agreement to Prevent Sale of Land.**—An agreement in consideration of the extension of an option that the defendant will pay a certain mortgage note owned by the plaintiff or otherwise prevent the sale of the land is not a promise to answer for the debt, etc., of another, within this section. *Whedbee v. Ruffin*, 189 N.C. 257, 126 S.E. 616 (1925).

**Promise to Guarantee Safety of Money.**—An oral promise to guarantee the safety of money placed in the promisor's hands for investment is not an agreement to answer for the debt of another within the meaning of this section. *Partin v. Prince*, 159 N.C. 553, 75 S.E. 1080 (1912).

**The obligation of one as guarantor of payment** must be evidenced and established by a written agreement, or some written note or memorandum signed by him or some person authorized to sign for him. *Standard Supply Co. v. Finch*, 147 N.C. 106, 60 S. E. 904 (1908); *Hickory Novelty Co. v. Andrews*, 188 N.C. 59, 123 S.E. 314 (1924).

**What Amounts to Contract of Guaranty.**—A telegram that the debtor is a reliable person and that any justifiable claims will be taken care of is insufficient to establish a contract of guaranty or a promise to answer for the debt, etc., of another, in the absence of a promise to pay the debt if the debtor does not pay. *Fain Grocery Co. v. Early & Daniels Co.*, 181 N.C. 459, 107 S.E. 497 (1921).

**Where a writing or notation is not a continuing guaranty**, each order being a separate and independent transaction, the defendant is bound only for the order upon which his guaranty appears. *Gennett v. Lyerly*, 207 N.C. 201, 176 S.E. 275 (1934).

**Goods Furnished to Son on Father's Credit.**—If goods are furnished to a son upon the promise and credit of the father, the promise need not be in writing; but if the son was the principal debtor and the father merely a surety, the promise must be in writing. *White v. Tripp*, 125 N.C. 523, 34 S.E. 686 (1899).

**Goods Shipped to Business Run in Father's Name by Son.**—Where a business run in the name of J. W. J. was in charge of W. P. J., J. W. J.'s son, and J. W. J.

being desirous of having goods shipped to W. P. J. permitted them to be shipped in the name of J. W. J. & Son, saying to plaintiff, "you won't lose anything by it," and a payment on account was made by "J. W. J. & Son," this section was held inapplicable. *Noland Co. v. Jones*, 211 N.C. 462, 190 S.E. 720 (1937).

**A parol promise by owners of building to pay materialmen amount due them by contractor** cannot form the basis of a claim of lien by virtue of this section. *Roberts & Johnson Lumber Co. v. Horton*, 232 N.C. 419, 61 S.E.2d 100 (1950).

**Agreement to Pay Balance Due from Contractors by Their Surety.**—Plaintiff held assignments covering all funds to become due under a building contract, and was entitled to apply such funds to the extinguishment of claims it held for advancements made to carry on the work. Defendant, surety on the contractors' bond, orally agreed that if allowed to use part of the money received by plaintiff, on a payment under the contract, to pay claims for labor and materials so the construction could be carried on without going outside of the funds derived from the work, it would pay the balance due plaintiff from the contractors. It was held that such agreement was not within this section. *National Sur. Co. v. Jackson County Bank*, 20 F.2d 644 (4th Cir. 1927); *Warren v. White*, 251 N.C. 729, 112 S.E.2d 522 (1960).

**Contract to Pay for Labor and Materials Furnished on Airplanes.**—A cause of action based upon an original contract of a corporation, made for it in its name by its president, to pay for labor and materials furnished on airplanes, was not within the provisions of this section. *Piedmont Aviation, Inc. v. S & W Motor Lines, Inc.*, 262 N.C. 135, 136 S.E.2d 658 (1964).

**President and Principal Stockholder Promising Personal Liability.**—This section does not apply to representations by the president and principal stockholder of a corporation that he, personally, in addition to the corporation, would be obligated for the payment of the contract price for certain construction work, which representations were the agreement upon which plaintiffs accepted and performed the contract, since such agreement involves an original promise or undertaking on the part of the president at the time credit was extended. *May v. Charles C. Haynes Jr. Constr. Co.*, 252 N.C. 583, 114 S.E.2d 271 (1960).

**Agreement of Stockholders to Be Re-**



**sponsible for Merchandise.**—Defendants agreed orally to be personally responsible for merchandise shipped to a corporation of which they were the main stockholders and which they later took over. It was held that the agreement was an original promise not coming within the statute of frauds. *Brown v. Benton*, 209 N.C. 285, 183 S.E. 292 (1936).

**A promise by the president of a bank to become personally liable for a deposit** when supported by a new and independent consideration constitutes an original undertaking by him, and the agreement does not come within the provisions of this section. *Dillard v. Walker*, 204 N.C. 16, 167 S.E. 636 (1933).

**The guaranty of payment of a deposit made by the vice-president, director and stockholder of the bank** was an original promise to answer for the debt, upon sufficient consideration and does not come within the provisions of this section, and upon the insolvency of the bank and loss to the depositor the plea of the statute of frauds is not a valid defense. *Garren v. Youngblood*, 207 N.C. 86, 176 S.E. 252 (1934).

**The president and treasurer of a corporation who has no personal, immediate and pecuniary benefit** in the purchase of materials by the corporation is not an original promisor under this section and may not be held personally liable for the purchase price because of verbal promises to answer for the benefit made in his behalf by the secretary for the corporation as his alleged agent. *Gennett v. Lyerly*, 207 N.C. 201, 176 S.E. 275 (1934).

**§ 22-2. Contract for sale of land; leases.**—All contracts to sell or convey any lands, tenements or hereditaments, or any interest in or concerning them, and all leases and contracts for leasing land for the purpose of digging for gold or other minerals, or for mining generally, of whatever duration; and all other leases and contracts for leasing lands exceeding in duration three years from the making thereof, shall be void unless said contract, or some memorandum or note thereof, be put in writing and signed by the party to be charged therewith, or by some other person by him thereto lawfully authorized. (29 Charles II, c. 3, ss. 1, 2, 3; 1819, c. 1016, P. R.; 1844, c. 44; R. C., c. 50, s. 11; 1868, c. 156, ss. 2, 33; Code, ss. 1554, 1743; Rev., s. 976; C. S., s. 988.)

I. In General.

II. What Constitutes an Interest in or Concerning Land.

III. Sufficiency of Compliance with Section.

A. In General.

B. The Signature.

C. Statement of Consideration.

IV. Part Performance.

V. Pleading and Practice.

**An oral guarantee of genuineness or validity of a note** and the liability of the maker to pay it, made by the holder upon a transfer of it for value, is not a promise contemplated by this section to be in writing. *Adcock v. Fleming*, 19 N.C. 225 (1837); *Ashford v. Robinson*, 30 N.C. 114 (1847); *Rowland v. Rorke*, 49 N.C. 337 (1857).

**Agreement to Furnish Merchandise for Use on Farm.**—Evidence on defendant's statements to plaintiff merchant at the time plaintiff agreed to furnish certain merchandise for use on defendant's farm is held susceptible of the interpretation that defendant's promise to pay therefor was an original promise not coming within this section, and not a superadded one barred by the statute, and the question of interpretation should have been submitted to the jury. *Dozier v. Wood*, 208 N.C. 414, 181 S.E. 336 (1935).

**Promise to Save Landlord Releasing Lien from Harm on Appeal Bond.**—One financially interested in a crop induced the landlord to part with his lien, in order that the tenant might retain possession, and to sign an appeal bond of the tenant, and promised to save the landlord from harm thereon. The landlord was required to pay the bond. It was held that the release of the landlord's lien was sufficient consideration for the promise to save from harm, and the transaction was not within this section. *Jennings v. Keel*, 196 N.C. 675, 146 S.E. 716 (1929).

**Cross Reference.**

See also §§ 43-38 and 47-18.

**I. IN GENERAL.**

**Editor's Note.**—For note on recovery of payments by vendee under contract void under statute of frauds, see 30 N.C.L. Rev. 292 (1952). For note on rights of lessees under oral leases, see 31 N.C.L. Rev. 498 (1953). For comment on parol boun-

dary settlements, see 40 N.C.L. Rev. 304 (1962). For note on recovery by third party beneficiary on quantum meruit, see 41 N.C.L. Rev. 890 (1963).

**Purpose of Section Is to Prevent Fraud.**—Contracts within the meaning of this section were required to be in writing, to prevent frauds and perjuries. *Winberry v. Koonce*, 83 N.C. 351 (1880).

This section will not prevent an unwritten promise from being the basis for an action to cancel a deed where the promise was merely a device to accomplish fraud, and the relief sought is not to enforce the promise or to recover damages for its breach. *Mitchell v. Mitchell*, 206 N.C. 546, 174 S.E. 447 (1934).

A suitor will not be permitted to make use of the statute of frauds, not to prevent a fraud upon himself, but to commit a fraud upon his adversary. *Johnson v. Noles*, 224 N.C. 542, 31 S.E.2d 637 (1944).

**Construction of Section.**—This section has not been given a literal or narrow construction. The decisions of the Supreme Court have consistently given that interpretation which would accomplish the purpose declared in the English statute. Even though the statute declares leases and conveyances void, that word has been regularly interpreted to mean voidable. *Herring v. Volume Merchandise, Inc.*, 249 N.C. 221, 106 S.E.2d 197 (1958).

This section goes to the substance as well as the remedy. *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962).

**Section Supplemented by § 47-18.**—This section and the Connor Act, § 47-18, requiring registration of deeds and leases, were designed to accomplish the same purpose. The latter act supplements the earlier act. *Herring v. Volume Merchandise, Inc.*, 249 N.C. 221, 106 S.E.2d 197 (1958).

**Who May Plead Statute.**—Any person, plaintiff or defendant, against whom enforcement is sought may plead the statute of frauds against a contract voidable under the statute of frauds. *Davis v. Lovick*, 226 N.C. 252, 37 S.E.2d 680 (1946).

This section applies to executory and not executed contracts. *Choat v. Wright*, 13 N.C. 289 (1830); *Bailey v. Bishop*, 152 N.C. 383, 67 S.E. 968 (1910); *Rogers v. Gennett Lumber Co.*, 154 N.C. 108, 69 S.E. 788 (1910); *Herndon v. Durham & So. R.R.*, 161 N.C. 650, 77 S.E. 683 (1913); *Keith Bros. v. Kennedy*, 194 N.C. 784, 140 S.E. 721 (1927); *Willis v. Willis*, 242 N.C. 597, 89 S.E.2d 152 (1955); *Herring v. Volume Merchandise, Inc.*, 249 N.C. 221, 106 S.E.2d 197 (1958). See *Sprinkle v. Ponder*,

233 N.C. 312, 64 S.E.2d 171 (1951); *Dobias v. White*, 240 N.C. 680, 83 S.E.2d 785 (1954).

Where a contract was for the sale of an automobile in consideration of the conveyance of certain realty, and the vendor executed a good and sufficient deed, it was held that the contract was executed as to the conveyance of lands under this section. *Keith Bros. v. Kennedy*, 194 N.C. 784, 140 S.E. 721 (1927).

**A wholly unexecuted parol contract to sell land is void.** *Riggs v. Anderson*, 260 N.C. 221, 132 S.E.2d 312 (1963).

**Parol Trusts Are Valid Generally.**—The seventh section of the English statute of frauds, forbidding the creation of parol trusts unless manifested and proved by some writing, is not in force in North Carolina and no statute of equivalent import has been enacted. Hence, parol trusts have a recognized place in this State's jurisprudence and have been sanctioned and upheld. *Gaylord v. Gaylord*, 150 N.C. 222, 63 S.E. 1028 (1909), citing *Shelton v. Shelton*, 58 N.C. 292 (1859); *Jones v. Jones*, 164 N.C. 320, 80 S.E. 430 (1913); *Wilson v. Jones*, 176 N.C. 205, 97 S.E. 18 (1918); *Kelly Springfield Tire Co. v. Lester*, 192 N.C. 642, 135 S.E. 778 (1926); *Winner v. Winner*, 222 N.C. 414, 23 S.E.2d 251 (1942). See also *Pittman v. Pittman*, 107 N.C. 159, 12 S.E. 61 (1890); *Cobb v. Edwards*, 117 N.C. 244, 23 S.E. 241 (1895); *Anderson v. Harrington*, 163 N.C. 140, 79 S.E. 426 (1913); *Lutz v. Hoyle*, 167 N.C. 632, 83 S.E. 749 (1914); *Newby v. Atlantic Coast Realty Co.*, 182 N.C. 34, 108 S.E. 323 (1921); *Blue v. Wilmington*, 186 N.C. 321, 119 S.E. 741 (1923); *Cunningham v. Long*, 186 N.C. 526, 120 S.E. 81 (1923); *Peele v. LeRoy*, 222 N.C. 123, 22 S.E.2d 244 (1942); *Taylor v. Addington*, 222 N.C. 393, 23 S.E.2d 318 (1942); *Thompson v. Davis*, 223 N.C. 792, 28 S.E.2d 556 (1944); *Embler v. Embler*, 224 N.C. 811, 32 S.E.2d 619 (1945); *Atkinson v. Atkinson*, 225 N.C. 120, 33 S.E.2d 666 (1945); *Carlisle v. Carlisle*, 225 N.C. 462, 35 S.E.2d 418 (1945); *Robertson v. Bemis*, 226 Fed. 828 (E.D.N.C. 1915).

Parol trusts have been held valid in the following cases involving, generally, trusts in land for the benefit of others than the grantor: *Hargrave v. King*, 40 N.C. 430 (1848) (dictum); *Cloninger v. Summit*, 55 N.C. 513 (1856); *Cousins v. Wall*, 56 N.C. 43 (1856); *Hanff v. Howard*, 56 N.C. 440 (1857); *Shelton v. Shelton*, 58 N.C. 292 (1859); *Riggs v. Swann*, 59 N.C. 118 (1860) (as to slaves); *Cohn v. Chapman*, 62 N.C. 92 (1867); *Cobb v. Edwards*, 117 N.C. 245, 23 S.E. 241 (1895); *Owens v.*

Williams, 130 N.C. 165, 41 S.E. 93 (1902); Sykes v. Boone, 132 N.C. 199, 43 S.E. 645 (1903); Avery v. Stewart, 136 N.C. 426, 48 S.E. 775 (1904); Anderson v. Harrington, 163 N.C. 140, 79 S.E. 426 (1913); Jones v. Jones, 164 N.C. 320, 80 S.E. 430 (1913); Lutz v. Hoyle, 167 N.C. 632, 83 S.E. 749 (1914); Rush v. McPherson, 176 N.C. 562, 97 S.E. 613 (1918); Cunningham v. Long, 186 N.C. 526, 120 S.E. 81 (1923); Thompson v. Davis, 223 N.C. 792, 28 S.E.2d 556 (1944); Embler v. Embler, 224 N.C. 811, 32 S.E.2d 619 (1945); Carlisle v. Carlisle, 225 N.C. 462, 35 S.E.2d 418 (1945); and in these cases involving, generally, division of profits arising from the disposition of land: Michael v. Foil, 100 N.C. 178, 6 S.E. 264 (1888); Sprague v. Bond, 108 N.C. 382, 13 S.E. 143 (1891); Bourne v. Sherrill, 143 N.C. 381, 55 S.E. 799 (1906); Brown v. Hobbs, 147 N.C. 73, 60 S.E. 716 (1908); Brogden v. Gibson, 165 N.C. 16, 80 S.E. 966 (1914); Newby v. Atlantic Coast Realty Co., 182 N.C. 34, 108 S.E. 323 (1921); Peele v. LeRoy, 222 N.C. 123, 22 S.E.2d 244 (1942).

**This section has no application to parol trusts.** Hargrave v. King, 40 N.C. 430 (1848); Cloninger v. Summit, 55 N.C. 513 (1856); Cousins v. Wall, 56 N.C. 43 (1856); Hanff v. Howard, 56 N.C. 440 (1857); Riggs v. Swann, 59 N.C. 118 (1860); Russell v. Wade, 146 N.C. 116, 59 S.E. 345 (1907); Cobb v. Edwards, 117 N.C. 244, 23 S.E. 241 (1895); Owens v. Williams, 130 N.C. 165, 41 S.E. 93 (1902); Sykes v. Boone, 132 N.C. 199, 43 S.E. 645 (1903); Avery v. Stewart, 136 N.C. 426, 48 S.E. 775 (1904); Anderson v. Harrington, 163 N.C. 140, 79 S.E. 426 (1913); Jones v. Jones, 164 N.C. 320, 80 S.E. 430 (1913); Brogden v. Gibson, 165 N.C. 16, 80 S.E. 966 (1914); Lutz v. Hoyle, 167 N.C. 632, 83 S.E. 749 (1914); Boone v. Lee, 175 N.C. 383, 95 S.E. 659 (1918); Newby v. Atlantic Coast Realty Co., 182 N.C. 34, 108 S.E. 323 (1921); Peele v. LeRoy, 222 N.C. 123, 22 S.E.2d 244 (1942); Thompson v. Davis, 223 N.C. 792, 28 S.E.2d 556 (1944); Embler v. Embler, 224 N.C. 811, 32 S.E.2d 619 (1945). See, for example, the language of Pearson, C.J., in Shelton v. Shelton, 58 N.C. 292 (1859), quoted with approval in Jones v. Jones, 164 N.C. 320, 80 S.E. 430 (1913), and Thompson v. Davis, 223 N.C. 792, 28 S.E.2d 556 (1944): "A bare perusal of the statute [Acts 1819, Rev. Code, c. 50, § 11] will suffice to show that it cannot, by any rule of construction, be made to include a declaration of trusts, so as to supply the place of the section of the English statute of frauds in regard to a parol dec-

laration of trusts, which our legislature has omitted to re-enact."

**Nor does this section prohibit their establishment by parol evidence.** Shelton v. Shelton, 58 N.C. 292 (1859); Riggs v. Swann, 59 N.C. 118 (1860); Jones v. Jones, 164 N.C. 320, 80 S.E. 430 (1913); Thompson v. Davis, 223 N.C. 792, 28 S.E.2d 556 (1944). And in Thompson v. Davis it is further stated (223 N.C. at p. 794): "Parol evidence introduced to establish such a trust does not violate the rule of evidence prohibiting the admission of parol evidence to contradict, alter or explain a written instrument, since such is not its purpose or effect." But the evidence must be clear, strong and convincing. Jefferson Standard Life Ins. Co. v. Morehead, 209 N.C. 174, 183 S.E. 606 (1936).

**Thus, parol trusts remain as at common law.** Shelton v. Shelton, 58 N.C. 292 (1859); Pittman v. Pittman, 107 N.C. 159, 12 S.E. 61 (1890); Anderson v. Harrington, 163 N.C. 140, 79 S.E. 426 (1913); Lutz v. Hoyle, 167 N.C. 632, 83 S.E. 749 (1914); Cunningham v. Long, 186 N.C. 526, 120 S.E. 81 (1923); Peele v. LeRoy, 222 N.C. 123, 22 S.E.2d 244 (1942).

**But Must Be Declared Prior to or Contemporaneously with Transfer of Legal Title.**—Parol trusts must be declared prior to or contemporaneously with the transfer of legal title. Owens v. Williams, 130 N.C. 165, 41 S.E. 93 (1902) (prior parol declaration and land conveyed pursuant thereto); Sykes v. Boone, 132 N.C. 199, 43 S.E. 645 (1903); Jones v. Jones, 164 N.C. 320, 80 S.E. 430 (1913); Lutz v. Hoyle, 167 N.C. 632, 83 S.E. 749 (1914). A declaration is said to be contemporaneous, in the sense that it is a part of the same transaction in which the sale is accomplished. Kelly v. McNeill, 118 N.C. 349, 24 S.E. 738 (1896). For cases stating only that the declaration must be contemporaneous, see Riggs v. Swann, 59 N.C. 118 (1860) ("at the time the legal title passes"); Pittman v. Pittman, 107 N.C. 159, 12 S.E. 61 (1890); Blackburn v. Blackburn, 109 N.C. 488, 13 S.E. 937 (1891); Hamilton v. Buchanan, 112 N.C. 463, 17 S.E. 159 (1893) ("at the time of the sale"); Peele v. LeRoy, 222 N.C. 123, 22 S.E.2d 244 (1942). But see Cobb v. Edwards, 117 N.C. 245, 23 S.E. 241 (1895), wherein it is said at page 247: "... where the grantor by a mere declaration engrafts upon his own deed a trust, the declaration must be neither prior nor subsequent to but contemporaneous with its execution," citing Smiley v. Pearce, 98 N.C. 185, 3 S.E. 631 (1887), and Blount v. Washington, 108 N.C. 230, 12



S.E. 1008 (1891), and quoted in *Embler v. Embler*, 224 N.C. 811, 32 S.E.2d 619 (1945).

**And if declared subsequent to the transmission of title, parol trusts will not be upheld.** *Smiley v. Pearce*, 98 N.C. 185, 3 S.E. 631 (1887); *Pittman v. Pittman*, 107 N.C. 159, 12 S.E. 61 (1890); *Blount v. Washington*, 108 N.C. 230, 12 S.E. 1008 (1891); *Hamilton v. Buchanan*, 112 N.C. 463, 17 S.E. 159 (1893) (invalid under statute of frauds); *Cobb v. Edwards*, 117 N.C. 245, 23 S.E. 241 (1895); *Embler v. Embler*, 224 N.C. 811, 32 S.E.2d 619 (1945); *Loftin v. Kornegay*, 225 N.C. 490, 35 S.E.2d 607 (1945) (void under statute of frauds). It was said in *Kelly v. McNeill*, 118 N.C. 349, 24 S.E. 738 (1896): "Subsequent agreements by parol are void, under the statute of frauds, whether made the next moment or the next year."

After title to real property has passed, any oral agreement to engraft a trust thereon falls within the statute of frauds, and no action for a breach thereof can be maintained. *Humphrey v. Faison*, 247 N.C. 127, 100 S.E.2d 524 (1957).

**Moreover, Parol Trust in Favor of Grantor Is Invalid.**—Upon the creation of parol trusts, the authorities seem to have declared or established the limitation that except in cases of fraud, mistake or undue influence, a parol trust, to arise by reason of the contract or agreement of the parties thereto, will not be set up or engrafted in favor of the grantor upon a written deed conveying to the grantee the absolute title, and giving clear indication on the face of the instrument that such a title was intended to pass. *Gaylord v. Gaylord*, 150 N.C. 222, 63 S.E. 1028 (1909); *Jones v. Jones*, 164 N.C. 320, 80 S.E. 430 (1913); *Colonial Trust Co. v. Sterchie Bros.*, 169 N.C. 21, 85 S.E. 40 (1915); *Campbell v. Sigmon*, 170 N.C. 348, 87 S.E. 116 (1915); *Walters v. Walters*, 171 N.C. 312, 88 S.E. 438 (1916); *Walters v. Walters*, 172 N.C. 328, 90 S.E. 304 (1916); *Chilton v. Smith*, 180 N.C. 472, 105 S.E. 1 (1920); *Swain v. Goodman*, 183 N.C. 531, 112 S.E. 36 (1922); *Blue v. Wilmington*, 186 N.C. 321, 119 S.E. 741 (1923); *Williams v. McRackan*, 186 N.C. 381, 119 S.E. 746 (1923) (concurring opinion by Clark, C.J., referring to *Gaylord v. Gaylord*, supra, as "well reasoned and clearly enunciated, and . . . recognized as a leading case . . ."); *Kelly Springfield Tire Co. v. Lester*, 192 N.C. 642, 135 S.E. 778 (1926); *Waddell v. Aycock*, 195 N.C. 268, 142 S.E. 10 (1928); *Taylor v. Addington*, 222 N.C. 393, 23 S.E.2d 318 (1942); *Winner v. Winner*, 222 N.C. 414, 23 S.E.2d 251 (1942); *Carlisle v. Carlisle*, 225 N.C. 462, 35 S.E.2d 418 (1945); *Loftin v. Kornegay*,

225 N.C. 490, 35 S.E.2d 607 (1945); *McCullen v. Durham*, 229 N.C. 418, 50 S.E.2d 511 (1948); *Walker v. Walker*, 231 N.C. 54, 55 S.E.2d 801 (1949); *Jones v. Brinson*, 231 N.C. 63, 55 S.E.2d 808 (1949); *Vincent v. Corbett*, 244 N.C. 469, 94 S.E.2d 329 (1956); *Conner v. Ridley*, 248 N.C. 714, 104 S.E.2d 845 (1958).

Parol trusts will not be permitted or established by reason of contemporaneous parol contracts and agreements between the parties when the same are in direct conflict with the expressed stipulations of the written deed and the entire purport of the instrument. In such case and to that extent the doctrine of parol trusts is subordinated to another well-recognized principle of law, that when parties have formally and explicitly expressed their entire contract in writing, the same shall not be contradicted or changed by contemporaneous stipulations and agreements resting in parol. *Gaylord v. Gaylord*, 150 N.C. 222, 63 S.E. 1028 (1909). See, also brief references to this in 35 A.L.R. 285 and 33 N.C.L. Rev. 227 (1955).

It was no doubt in deference to this principle [that a parol trust will not be set up in favor of the grantor upon a written deed conveying to the grantee the absolute title] that a verdict was rendered in favor of defendant grantee in the instant case, where the issue was addressed to the interest alleged in favor of the grantor in the deed; but as to those who were not directly parties to the instrument it is well established that a parol trust of this kind may be established by parol declarations contemporary with the making of the deed or prior thereto and existent at the time the same was executed and title passed. *Jones v. Jones*, 164 N.C. 320, 80 S.E. 430 (1913).

The qualification that a parol trust cannot be established in favor of the grantor without an allegation of fraud or mistake stands upon a different footing and has no application to the facts in the instant case in which the trust was not sought to be established and enforced by the grantor, but by others not parties to the deed. *Thompson v. Davis*, 223 N.C. 792, 28 S.E.2d 556 (1944).

If, notwithstanding the solemn recitals and covenants in a deed, the grantor could show a parol trust in himself it would virtually do away with the statute of frauds and would be a most prolific source of fraud and litigation. *Campbell v. Sigmon*, 170 N.C. 348, 87 S.E. 116 (1915), involving a parol agreement to reconvey.

A parol trust cannot be established between the parties in favor of the grantor

in a deed, when the effect will be to contradict or change by a contemporaneous oral agreement the written contract clearly and fully expressed. To permit the terms of a solemn conveyance, absolute on its face, to be contradicted by a contemporaneous parol agreement would be in the teeth of the letter and the intent of the statute of frauds. *Chilton v. Smith*, 180 N.C. 472, 105 S.E. 1 (1920).

Parol trusts were not raised in favor of the grantor in the following cases involving, generally, parol agreements between grantor and grantee by which the grantee was to reconvey: *Campbell v. Campbell*, 55 N.C. 364 (1856) (agreement void under the statute of frauds); *Bonham v. Craig*, 80 N.C. 224 (1879); *Campbell v. Sigmon*, 170 N.C. 348, 87 S.E. 116 (1915); *Newton v. Clark*, 174 N.C. 393, 93 S.E. 951 (1917); *Chilton v. Smith*, 180 N.C. 472, 105 S.E. 1 (1920); *Swain v. Goodman*, 183 N.C. 531, 112 S.E. 36 (1922) (parol promise in contravention of statute of frauds); *Wolfe v. North Carolina Joint Stock Land Bank*, 219 N.C. 313, 13 S.E.2d 533 (1941); *Winner v. Winner*, 222 N.C. 444, 23 S.E.2d 251 (1942); *Loftin v. Kornegay*, 225 N.C. 490, 35 S.E.2d 607 (1945); *Poston v. Bowen*, 228 N.C. 202, 44 S.E.2d 881 (1947); *Walker v. Walker*, 231 N.C. 54, 55 S.E.2d 801 (1949); *Jones v. Brinson*, 231 N.C. 63, 55 S.E.2d 808 (1949); *Vincent v. Corbett*, 244 N.C. 469, 94 S.E.2d 329 (1956); *Conner v. Ridley*, 248 N.C. 714, 104 S.E.2d 845 (1958).

**Resulting Trusts.** — Resulting trusts, which arise by operation of law, do not come within the statute of frauds, and may be proved by parol evidence. *Wilson v. Williams*, 215 N.C. 407, 2 S.E.2d 19 (1939).

The statute of frauds has no application to a resulting trust, arising while plaintiffs furnished the full purchase price for certain lots, defendants took title thereto in their own names and built a dwelling on one of the lots for plaintiffs, for which plaintiffs paid them in full, and thereafter conveyed only part of the lots to plaintiffs. *Hoffman v. Mozeley*, 247 N.C. 121, 100 S.E.2d 243 (1957).

**Statute Is Not Applicable to Abrogation of Contracts.** — The statute of frauds applies to the making of enforceable contracts to sell or convey land, not to their abrogation. As a consequence, an executory written contract to sell or convey real property may be abandoned or canceled by mutual agreement orally expressed. *Scott v. Jordan*, 235 N.C. 244, 69 S.E.2d 557 (1952).

**Nor to Lease for One Year.** — A lease for one year need not be in writing. *Carolina*

*Helicopter Corp. v. Cutter Realty Co.*, 263 N.C. 139, 139 S.E.2d 362 (1964).

**Oral Statement of Lessor's Son-in-Law as Modifying Lease.** — Where a lease for a term of five years was in writing as required by this section, an oral statement of the lessor's son-in-law forbidding lessee to have anything to do with the furnace, an appurtenance of the demised premises, could not have the effect of modifying the written lease, certainly in the absence of evidence that the son-in-law had legal authority and was an agent of the lessor to agree or assent to a change in the written lease. *Rickman Mfg. Co. v. Gable*, 246 N.C. 1, 97 S.E.2d 672 (1957).

**Alleged oral promise of permanent employment entitling plaintiff to a lifetime lease** on the property even though the lease was not in writing is void under this section. *Craig v. Texaco, Inc.*, 218 F. Supp. 789 (E.D.N.C. 1963), aff'd, 326 F.2d (4th Cir. 1964).

**A contract for the construction of a house** for a man to live in is not required to be in writing. *Rankin v. Helms*, 244 N.C. 532, 94 S.E.2d 651 (1956).

**Written Agreement to Adopt Minor.** — Where intestate made a written agreement with parents of a minor to adopt minor and make her his sole heir in consideration of the parents agreeing to the adoption, such agreement, being in writing, did not come within the provisions of this section. *Chambers v. Byers*, 214 N.C. 373, 199 S.E. 398 (1938).

**Parol Evidence to Establish Contract of Sale.** — Under this section, parol evidence is incompetent to establish agreement to pay purchase price, so as to show that contract was one of sale and not an option, since this is an essential element of a contract of sale and purchase, and an essential element of a contract required to be in writing may not be established by parol. *Kluttz v. Allison*, 214 N.C. 379, 199 S.E. 395 (1938).

**Effect of Noncompliance.** — The contracts which are not entered into in compliance with this section are not void, but voidable merely at the instance of the party charged. And when such party takes advantage of the provisions of the statute, he repudiates the contract in its entirety and cannot derive any benefit from it. For example a vendee cannot recover the money he has paid the vendor under a parol contract which he has repudiated. *Durham Consol. Land & Improvement Co. v. Guthrie*, 116 N.C. 381, 21 S.E. 952 (1895). They are enforceable unless the party to be charged takes advantage of the statute.



McCall v. Textile Industrial Institute, 189 N.C. 775, 128 S.E. 349 (1925).

The statute of frauds affects not only the enforcement of contracts coming within its terms but also their validity. Jamerson v. Logan, 228 N.C. 540, 46 S.E.2d 561 (1948).

**Rights of Vendee under Parol Contract.**

—The vendor, in a parol contract to convey land, will not be permitted to evict a vendee who has entered and made improvements, until the latter has been repaid the purchase money and compensated for betterments. Union Cent. Life Ins. Co. v. Cordon, 208 N.C. 723, 182 S.E. 496 (1935), citing Vann v. Newsom, 110 N.C. 122, 14 S.E. 519 (1892), and Eaton v. Doub, 190 N.C. 14, 128 S.E. 494, 40 A.L.R. 273 (1925). See Dupree v. Moore, 227 N.C. 626, 44 S.E.2d 37 (1947).

**Purchaser Takes with Notice of Enforceable Parol Lease.**—Purchaser of real property takes with notice that the premises may be under parol lease for a term not exceeding three years, but beyond that period he is protected by provision that the lease must have been in writing. Wright v. Allred, 226 N.C. 113, 37 S.E.2d 107 (1946).

**An oral agreement of arbitration as to real property cannot be enforced.** Fort v. Allen, 110 N.C. 183, 14 S.E. 685 (1892).

**Recovery on Quantum Meruit for Services Rendered Pursuant to Parol Contract to Devise.**—A parol contract to devise realty in consideration of personal services is unenforceable under the statute of frauds, but where the services have been rendered in reliance upon the promise to devise, the law substitutes in place of the unenforceable promise a valid promise to pay the reasonable worth of the services, and recovery may be had upon quantum meruit, the mainspring of the statute of frauds being to prevent frauds and not to promote them. Stewart v. Wyrick, 228 N.C. 429, 45 S.E.2d 764 (1947).

As to recovery on quantum meruit for services rendered pursuant to oral contract to devise, see 26 N.C.L. Rev. 417.

**Applied in** Russos v. Bailey, 228 N.C. 783, 47 S.E.2d 22 (1948); Rochlin v. P. S. West Constr. Co., 234 N.C. 443, 67 S.E.2d 464 (1951), commented on in 30 N.C.L. Rev. 292 (1952); Darden v. Houtz, 234 F. Supp. 261 (E.D.N.C. 1964).

**Cited in** Crech v. Crech, 222 N.C. 656, 24 S.E.2d 642 (1943); Buford v. Mochy, 224 N.C. 235, 29 S.E.2d 729 (1944); Williams v. Joines, 228 N.C. 141, 44 S.E.2d 738 (1947); Perkins v. Langdon, 237 N.C. 159, 74 S.E.2d 634 (1953); Clark v. Butts, 240 N.C. 709, 83 S.E.2d 885 (1954); Douglass v. Brooks, 242 N.C. 178, 87 S.E.2d 258

(1955); Dunn v. Dunn, 242 N.C. 234, 87 S.E.2d 308 (1955).

## II. WHAT CONSTITUTES AN INTEREST IN OR CONCERNING LAND.

The authority of a duly authorized agent to contract to convey lands need not be in writing under the statute of frauds. Wellman v. Horn, 157 N.C. 170, 72 S.E. 1010 (1911); Lewis v. Allred, 249 N.C. 486, 106 S.E.2d 689 (1959).

**A mere contract between a broker and the owner of land to negotiate a sale of the latter's land is not required to be in writing.** Carver v. Britt, 241 N.C. 538, 85 S.E.2d 888 (1955).

**A restrictive covenant creates a negative easement within the statute of frauds, and cannot be proved by parol.** Hege v. Sellers, 241 N.C. 240, 84 S.E.2d 892 (1954).

Covenants limiting the use of real property are within the scope of the statute of frauds and the registration act. Herring v. Volume Merchandise, Inc., 249 N.C. 221, 106 S.E.2d 197 (1958).

**An easement is an interest in land and must be in writing.** Shepherd v. Duke Power Co., 140 F. Supp. 27 (M.D.N.C. 1956).

**Parol Transfer of Parol Contract.**—A parol transfer of the interest of a purchaser of land under a parol contract is invalid. Wilkie v. Womble, 90 N.C. 254 (1884).

**An agreement to buy and sell land at a profit is not a contract relating to any interest in land which is required to be in writing.** It relates only to profits of the land, and is valid even though not in writing. Newby v. Atlantic Coast Realty Co., 182 N.C. 34, 108 S.E. 323 (1921), citing Brogden v. Gibson, 165 N.C. 16, 80 S.E. 966 (1914).

The section contemplates those transactions in which there is a conveyance of land from one party to another; not those as to ventures for profits in realty. Newby v. Atlantic Coast Realty Co., 182 N.C. 34, 108 S.E. 323 (1921).

**Agreement That Is Not One to Sell or Convey Land.**—Where plaintiff alleged that his vendor agreed to procure a release of the land from a prior deed of trust upon the payment by the plaintiff of a note given for the balance of the purchase price of the land, and secured by a deed of trust to his vendor, the agreement is not one to sell or convey land, or any interest in or concerning same, and does not come within the provisions of this section. Hare v. Hare,

**A dower interest cannot be surrendered** 208 N.C. 442, 181 S.E. 246 (1935).

by parol. *Houston v. Smith*, 88 N.C. 312 (1883). As to abolition of dower and curtesy and right of surviving spouse to elect life estate, see §§ 29-4, 29-30.

An oral contract which undertakes to bind the plaintiff to release her dower interest in the lands of the defendant runs afoul of this section, which renders parol promises to surrender dower unenforceable. *Luther v. Luther*, 234 N.C. 429, 67 S.E.2d 345 (1951).

**Partition.**—A contract between tenants in common for the partition in lands is a contract concerning realty, within the meaning of this section. *Anders v. Anders*, 13 N.C. 529 (1830); *Medlin v. Steele*, 75 N.C. 154 (1876); *Fort v. Allen*, 110 N.C. 183, 14 S.E. 685 (1892); *Rhea v. Craig*, 141 N.C. 602, 54 S.E. 408 (1906).

A parol partition of land is a contract within the purview of this section, and is not binding. And in order for tenants in common to perfect title to the respective shares of land allotted to them by parol, it is necessary for them to go into possession of their respective shares in accordance with the agreement and to hold possession thereof under known and visible boundaries, consisting of lines plainly marked on the ground at the time of the partition, and to continue in possession openly, notoriously and adversely for twenty years. *Williams v. Robertson*, 235 N.C. 478, 70 S.E.2d 692 (1952).

**An oral contract to give or devise real estate** is void by reason of the statute of frauds, and no action for a breach thereof can be maintained. *Daughtry v. Daughtry*, 223 N.C. 528, 27 S.E.2d 446 (1943); *Clapp v. Clapp*, 241 N.C. 281, 85 S.E.2d 153 (1954); *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962). See *Neal v. Wachovia Bank & Trust Co.*, 224 N.C. 103, 29 S.E.2d 206 (1944).

An oral agreement to devise realty is within the statute of frauds and therefore unenforceable. *Gales v. Smith*, 249 N.C. 263, 106 S.E.2d 164 (1958).

An agreement to devise real property is within the statute of frauds. *Humphrey v. Faison*, 247 N.C. 127, 100 S.E.2d 524 (1957).

Upon a plea of the statute, an oral contract to convey or to devise real property may not be specifically enforced and no recovery of damages for the loss of the bargain can be predicated upon its breach. *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962).

A contract to devise real property comes within the provisions of this section, and performance of services by the promisee as consideration for the contract does not

take the contract out of the provisions of the section, and the promisee cannot successfully maintain an action for specific performance of the contract. *Grantham v. Grantham*, 205 N.C. 363, 171 S.E. 331 (1933). See *Coley v. Dalrymple*, 225 N.C. 67, 33 S.E.2d 477 (1945).

**An indivisible contract to devise real and personal property** comes within the statute of frauds. *Jamerson v. Logan*, 228 N.C. 540, 46 S.E.2d 561 (1948); *Humphrey v. Faison*, 247 N.C. 127, 100 S.E.2d 524 (1957); *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962).

**Agreement to Bequeath Personalty.**—An agreement to devise realty is within the statute of frauds, and an agreement to bequeath personalty, simpliciter, is not. *Stewart v. Wyrick*, 228 N.C. 429, 45 S.E.2d 764 (1947).

**Contract to Bequeath or Devise Must Be Established by Same Proof Required for Other Contracts.**—An aggrieved party may recover for the breach of a contract, made upon sufficient consideration, that the promisor will make him the beneficiary of a bequest or devise in his will, but such a contract must be established by the mode of proof legally permissible in establishing other contracts. *McCraw v. Llewellyn*, 256 N.C. 213, 123 S.E.2d 575 (1962).

**Crops and Fruit.**—Crops which are produced annually are personal chattels, and a sale of them while growing is only a sale of goods, and not a contract or sale of land, or any interest in or concerning land, under this section. *Brittain v. McKay*, 23 N.C. 265 (1840).

Fruits on trees cannot be reserved by the vendor by a parol agreement. *Flynt v. Conrad*, 61 N.C. 190 (1867).

**A parol crop-sharing agreement** by which certain tobacco land was to be leased and equipment, labor and supplies to be furnished by the parties did not involve an interest in land under this section and was valid. *Martin v. Stiers*, 165 F. Supp. 163 (M.D.N.C. 1958).

**Parol Agreement as to Division of Profits from Sale of Land.**—Where the grantor alleges that the grantee entered into a contemporaneous parol agreement to reconvey or to sell the land and divide the profits realized from the sale, and that the grantee had sold the property, the parol agreement as to the division of profits does not involve an interest in land and does not come within the statute of frauds, and, the part of the agreement coming within the statute having been executed, the original grantor may maintain an action for an accounting to determine whether or not any profit was realized from the sale for

a division under the agreement. *Schmidt v. Bryant*, 251 N.C. 838, 112 S.E.2d 262 (1960).

**Standing Timber.**—A contract conveying standing timber is a contract concerning realty. *Mizell v. Burnett*, 49 N.C. 249 (1857); *Drake v. Howell*, 133 N.C. 162, 45 S.E. 539 (1903); *Ward v. Gay*, 137 N.C. 397, 49 S.E. 884 (1905); *Ives v. Atlantic & N.C.R.R.*, 142 N.C. 131, 55 S.E. 74 (1906).

Growing trees are a part of the land, and a contract for the sale thereof comes within the meaning and intent of the statute of frauds. *Johnson v. Wallin*, 227 N.C. 669, 44 S.E.2d 83 (1947).

Standing trees on land are real property and contracts and conveyances in respect thereto are governed by the same rules applicable to other forms of real property. The statute of frauds defeats a parol conveyance or reservation of timber trees. *Westmoreland v. Lowe*, 225 N.C. 553, 35 S.E.2d 613 (1945).

**A contract of the owner of land to sell at a stipulated price all logs which the owner should cut from the tract** is not a contract affecting realty within the meaning of this section, since the cutting and delivery of the logs would constitute a conversion of the standing timber from real property into personalty. *Walston v. Lowry*, 212 N.C. 23, 192 S.E. 877 (1937).

**Guaranty of Acreage.**—A vendor's guaranty of the number of acres need not be in writing. *Currie v. Hawkins*, 118 N.C. 593, 24 S.E. 476 (1896); *Sterne v. Benbow*, 151 N.C. 460, 66 S.E. 445 (1909).

Also an agreement between vendor and purchaser that the latter shall have the land surveyed, and that if it falls short the vendor shall refund pro tanto, need not be in writing. *Sherrill v. Hagan*, 92 N.C. 345 (1885).

**Equitable Estates.**—A parol contract of sale of an equitable estate in land is void. *Holmes v. Holmes*, 86 N.C. 205 (1882).

**Mortgage Absolute in Form.**—For discussion of effect of this section upon mortgage deeds absolute in form, see 26 N.C.L. Rev. 405.

**Parol Release of Mortgage.**—An agreement to terminate the relationship of a mortgagor and mortgagee does not fall within the intent and meaning of this section. Hence, a parol contract to release a part of the mortgaged property is valid and enforceable. *Hemmings v. Doss*, 125 N.C. 400, 34 S.E. 511 (1899); *Stevens v. Turlington*, 186 N.C. 191, 119 S.E. 210 (1923).

Where a mortgagee agreed by parol to release the mortgage to a purchaser of the land from the mortgagor, the mortgagee was held estopped to deny the validity of

the agreement under the statute of frauds. *Stevens v. Turlington*, 186 N.C. 191, 119 S.E. 210 (1923).

**Lease for One Year with Provision for Renewals.**—An oral lease of realty for one year, together with provision for annual renewals for four successive years, is but a single contract, the agreement for renewal being a part of and inseparable from lease for the original term, and holding for extended term would be under the original oral lease, and contract may not be divided so as to validate it for the initial period and disregard the other portion of the contract. *Wright v. Allred*, 226 N.C. 113, 37 S.E.2d 107 (1946).

**A parol lease for three years is not within the statute.** It must be for a term exceeding three years. *Smithdeal v. McAdoo*, 172 N.C. 700, 90 S.E. 907 (1916).

**But a parol lease agreement for more than three years is void.** *Barbee v. Lamb*, 225 N.C. 211, 34 S.E.2d 65 (1945).

**As Is Lease for Three Years to Commence in Futuro.**—In order to determine whether a lease is for more than three years or not the computation must be made from the time of making the agreement to lease, and not from the time of its going into effect. Hence, a parol agreement of lease for three years to commence in futuro is voidable by the lessor and renders the tenant a tenant at will. *Falkner v. Hunt*, 73 N.C. 571 (1875); *Mauney v. Norvell*, 179 N.C. 628, 103 S.E. 372 (1920).

Where the owner of land agrees to erect a certain kind of building thereon for a proposed lessee, and makes a parol lease for the rental of the property for three years to take effect upon the completion of the building, the lease for three years to take effect in the future comes within the provisions of the statute of frauds, and where in an action thereon the lessee denies the contract of lease and pleads the statute, he may not be held liable unless it was executed in writing, or some memorandum thereof made and signed by the party to be charged therewith or by some other person by him duly authorized. *Sammox Inv. Co. v. Zindel*, 198 N.C. 109, 150 S.E. 704 (1929).

**Lease for Duration of Life Estate.**—An agreement by the remainderman to rent the locus in quo from the life tenant for the entire period of the life estate is for an indefinite term and one which may last beyond three years and therefore such agreement comes within this section. *Davis v. Lovick*, 226 N.C. 252, 37 S.E.2d 680 (1946).

**Assignment of Lease for More Than Three Years.**—A verbal assignment of an



unexpired lease to continue more than three years is void under this section. *Alexander v. Morris*, 145 N.C. 22, 58 S.E. 600 (1907).

The English statute of frauds declares void parol assignments or surrenders of leases, but the English statute was not adopted as a part of the common law of North Carolina. The North Carolina statute, embodied in this section, makes no declaration with respect to the assignment or surrender of leases when an unexpired term exceeds three years. Nevertheless, though not mentioned in either this section or § 47-18, an assignment of a lease for more than three years must, to be enforceable, be in writing, and to protect against creditors or subsequent purchasers, must be recorded. *Herring v. Volume Merchandise, Inc.*, 249 N.C. 221, 106 S.E.2d 197 (1958).

**Surrender of Lease Having Over Three Years to Run.**—A parol offer to surrender a leasehold estate having more than three years to run is within the statute of frauds and cannot be specifically enforced. *Herring v. Volume Merchandise, Inc.*, 249 N.C. 221, 106 S.E.2d 197 (1958).

Because performance of a parol offer to surrender a leasehold estate having more than three years to run cannot be enforced so long as the contract is executory, that does not mean that a consummated surrender is invalid or that lessee may not by his conduct be estopped to deny the termination of his lease. *Herring v. Volume Merchandise, Inc.*, 249 N.C. 221, 106 S.E.2d 197 (1958).

**Negative Easement.**—A restriction on the use of land being in effect a negative easement is an interest in land required under this section to be contracted for in writing. *Davis v. Robinson*, 189 N.C. 589, 127 S.E. 697 (1925).

Where land in a development is sold by deeds containing certain restrictive covenants, the covenants are in the nature of an easement, and it would seem that ordinarily such easement may not be released by parol agreement. *Moore v. Shore*, 206 N.C. 699, 175 S.E. 117 (1934).

**Party Walls.**—The right to contribution for costs of a party wall is implied in law regardless of the promise; and hence enforceable notwithstanding that the agreement was not in writing. *Reid v. King*, 158 N.C. 85, 73 S.E. 168 (1911).

**Creation of Mill Dam.** — A permanent right to overflow land by the erection and maintenance of a mill dam cannot be created by parol. *Bridges v. Purcell*, 18

N.C. 492 (1836); *Ebert v. Disher*, 216 N.C. 36, 3 S.E.2d 301 (1939).

**Judicial Sales.**—Judicial sales were not within the contemplation of the legislature at the time of making this enactment. *Tate v. Greenlee*, 15 N.C. 149 (1833).

**Judgment.**—The statute of frauds does not require that a judgment constituting a lien on land should be assigned by a written instrument. *Winberry v. Koonce*, 83 N.C. 351 (1880).

### III. SUFFICIENCY OF COMPLIANCE WITH SECTION.

#### A. In General.

**No special form or instrument is required.** A letter, note, bill or draft is sufficient. *Neaves v. North State Mining Co.*, 90 N.C. 412 (1884).

**Contract May Be Partly Written and Partly Oral.**—A contract for the sale of land may be partly verbal and partly in writing, unless the writing purports to embrace all the contract. Thus where the vendor upon a conveyance by deed, verbally agreed that he would make good any deficiency in the acreage, it was held that this section did not require the agreement as to the quantity to be embraced by the written contract or deed. *McGee v. Craven*, 106 N.C. 351, 11 S.E. 375 (1890).

**What the Writing Must Contain.** — In order that a contract falling within the sphere of this section be enforceable it must appear that there is a writing containing expressly or by implication all the material terms of the alleged agreement which must have been signed as required by the section. *Gwathmey v. Cason*, 74 N.C. 5 (1876); *Hall v. Misenheimer*, 137 N.C. 183, 49 S.E. 104 (1904).

In order to constitute an enforceable contract within the provisions of this section, the written memorandum, though it may be informal, must be sufficiently definite to show the essential elements of a valid contract. It must embody the terms of the contract, names of vendor and vendee, and a description of the land to be conveyed, at least sufficiently definite to be aided by parol. *Smith v. Joyce*, 214 N.C. 602, 200 S.E. 431 (1939); *Elliott v. Owen*, 244 N.C. 684, 94 S.E.2d 833 (1956).

A memorandum or note must contain expressly or by necessary implication the essential features of an agreement to sell. *Lane v. Coe*, 262 N.C. 8, 136 S.E.2d 269 (1964).

Even though the contract be informally and awkwardly expressed in the writing, yet if its nature, scope and purpose clearly appear from it, there is a sufficient com-

pliance with the requirements of this section. *Mayer v. Adrian*, 77 N.C. 83 (1877); *Farmer v. Batts*, 83 N.C. 387 (1880); *Thornburg v. Masten*, 88 N.C. 293 (1883); *Gordon v. Collett*, 102 N.C. 532, 9 S.E. 486 (1889).

The memorandum of a contract to convey realty is insufficient if no buyer therein is identified in the slightest degree. *Elliott v. Owen*, 244 N.C. 684, 94 S.E.2d 833 (1956).

**The agreement must adequately express the intent and obligation of the parties.** Parol evidence cannot be received to supply anything which is wanting in the writing to make it the agreement on which the parties rely. *McCraw v. Llewellyn*, 256 N.C. 213, 123 S.E.2d 575 (1962).

The writing must show the promise or obligation which the complaining party seeks to enforce. *McCraw v. Llewellyn*, 256 N.C. 213, 123 S.E.2d 575 (1962).

**Writing Must Describe Subject Matter.**—In order to take an agreement relating to land out of the statute of frauds, the writing must describe the subject matter with certainty or refer to matters aliunde from which the description can be made certain. *Searcy v. Logan*, 226 N.C. 562, 39 S.E.2d 593 (1946).

A memorandum or note must contain a description of the land, the subject matter of the contract, either certain in itself or capable of being reduced to certainty by reference to something extrinsic to which the contract refers. *Lane v. Coe*, 262 N.C. 8, 136 S.E.2d 269 (1964).

**There Must Be No Patent Ambiguity.**—The only requisite in evaluating the written contract, as to the certainty of the thing described, is that there be no patent ambiguity in the description. *Lane v. Coe*, 262 N.C. 8, 136 S.E.2d 269 (1964).

**When Patent Ambiguity Exists.**—There is a patent ambiguity when the terms of the writing leave the subject of the contract, the land, in a state of absolute uncertainty, and refer to nothing extrinsic by which it might possibly be identified with certainty. *Lane v. Coe*, 262 N.C. 8, 136 S.E.2d 269 (1964).

**Patent Ambiguity Precludes Use of Parol Evidence.**—When the language of the writing is patently ambiguous, parol evidence is not admissible to aid the description. *Lane v. Coe*, 262 N.C. 8, 136 S.E.2d 269 (1964).

**Memorandum Inconsistent with Contract.**—Where the memorandum of a contract partly in parol was inconsistent with the terms of the contract, it was held that the memorandum not being the contract

between the parties, the plaintiff suing under the parol contract was not entitled to recover. *Keith v. Bailey*, 185 N.C. 262, 116 S.E. 729 (1923).

**Sufficiency of Description.**—This section does not render void a contract which contains a defective description merely. It only requires that the contract be in writing and signed by the party to be charged. *Durham Consol. Land & Improvement Co. v. Guthrie*, 116 N.C. 381, 21 S.E. 952 (1895).

The Supreme Court has uniformly recognized the principle that a deed conveying land, or a contract to sell and convey land, or a memorandum thereof, within the meaning of the statute of frauds must contain a description of the land, the subject matter thereof, either certain in itself or capable of being reduced to certainty by reference to something extrinsic to which the deed, contract or memorandum refers. *Kelly v. Kelly*, 246 N.C. 174, 97 S.E.2d 872 (1957).

If the description is sufficiently definite for the court, with the aid of extrinsic evidence, to apply the description to the exact property intended to be sold, it is enough. *Lane v. Coe*, 262 N.C. 8, 136 S.E.2d 269 (1964).

A written contract to convey the grantor's entire tract of land consisting of 146 acres was, under the circumstances of the case, held to be sufficiently certain as to the land conveyed, so as to admit parol evidence in regard to the identity of the land without violating the statute of frauds. *Norton v. Smith*, 179 N.C. 553, 103 S.E. 14 (1920). See *Higdon v. Rice*, 119 N.C. 623, 26 S.E. 256 (1896), where it is said that a defective description cannot be aided by parol testimony because that would mean no substitute by parol an essential portion of a contract required by this section to be in writing; though mistakes can be corrected and ambiguities explained by parol.

Where the calls of a deed are sufficiently definite, the locations cannot be changed by parol agreement unless contemporaneous. *Haddock v. Leary*, 148 N.C. 378, 62 S.E. 426 (1908).

The following memorandum found in the books of the defendant's intestate was held too vague and uncertain to take the contract out of the statute: "1841, W. P. to H. C. O. Dr. To 4 loads of Rock, one lot at one year's credit, \$125." *Plummer v. Owens*, 45 N.C. 254 (1853).

The memorandum of a sale of standing timber must be sufficiently definite in its essential elements to comply with the re-



quirements of the statute of frauds to enable the court to decree specific performance; but latent ambiguities may be explained by parol evidence. *Camp Mfg. Co. v. Jordan*, 292 Fed. 182 (E.D.N.C. 1923). See also *Keith v. Bailey*, 185 N.C. 262, 116 S.E. 729 (1923).

When all the circumstances of possession, ownership, and situation of the parties, and of their relation to each other and the property, as they were when the negotiation took place and the writing was made, are disclosed, if the meaning and application of the writing, read in the light of those circumstances, are certain and plain, the parties will be bound by it as a sufficient written contract or memorandum of their agreement. *Norton v. Smith*, 179 N.C. 553, 103 S.E. 14 (1920); *Gilbert v. Wright*, 195 N.C. 165, 141 S.E. 577 (1928).

Agreement "to buy the vacant lot," from the vendor was held not unenforceable under this section where the evidence showed that it was the only lot owned by the vendor anywhere. *Gilbert v. Wright*, 195 N.C. 165, 141 S.E. 577 (1928).

A memorandum "Received of C. L. \$50.00 for home place where he now lives which he has no deed for" dated and signed by the owner of land is sufficiently definite to admit of parol evidence for the purpose of identifying the land, and memorandum being sufficient under statute of frauds, purchaser may introduce another receipt executed by owner, even though it does not purport to identify the land, and show by parol that it was part of the consideration for the land contracted to be conveyed. *Searcy v. Logan*, 226 N.C. 562, 39 S.E.2d 593 (1946).

**Requisites of Deeds.**—A deed conveying land within the meaning of the statute of frauds must contain a description of the land, the subject matter of the deed, either certain in itself or capable of being reduced to certainty by reference to something extrinsic to which the deed refers. The office of description is to furnish, and is sufficient when it does furnish, means of identifying the land intended to be conveyed. The deed itself must point to the source from which evidence aliunde to make the description complete is to be sought. *Plemmons v. Cutshall*, 234 N.C. 506, 67 S.E.2d 501 (1951); *Powell v. Mills*, 237 N.C. 582, 75 S.E.2d 759 (1953).

The vendor of lands in substantial conformity with his parol agreement tendered the vendee a deed to the lands, which the latter refused because the amount of the agreed purchase price had been increased,

and after the vendor had sold the lands the vendee brought an action for damages. It was held that the deed tendered was a sufficient writing within the statute of frauds to bind the vendor, and the vendee could recover damages sustained by defendant's breach of contract to convey. *Oxendine v. Stephenson*, 195 N.C. 238, 141 S.E. 572 (1928).

**Deed Held to Be a Sufficient Writing.**—

A deed duly executed and acknowledged and found among the valuable papers of the grantor after his death is a sufficient writing within the meaning of the statute of frauds of a contract of grantor to convey the lands to the grantees in consideration of grantees' taking care of grantor for the remainder of his life. *Austin v. McCollum*, 210 N.C. 817, 188 S.E. 646 (1936).

**Letters Held Sufficiently Definite and Certain.**—Letters from testatrix to plaintiff held sufficiently definite and certain to constitute a memorandum of a contract to convey property to plaintiff in return for certain services. *Heiland v. Lee*, 207 F.2d 939 (4th Cir. 1953).

Letters from the agent for plaintiffs to defendants, and the reply of the agent for defendants, were a sufficient memorandum to meet the requirements of this section. *Hines v. Tripp*, 263 N.C. 470, 139 S.E.2d 545 (1965).

**Parol Acceptance of Option.**—A written option offering to sell, at the election of the optionee, can become binding on the owner by verbal notice to the owner, but a parol acceptance by the optionee is not sufficient to repel the statute of frauds and bind the optionee. *Warner v. W & O, Inc.*, 263 N.C. 37, 138 S.E.2d 782 (1964).

**A parol agreement of the conditional delivery of a written contract for the conveyance of land is valid; it does not contradict the written instrument, but only postpones its effectiveness until after the condition has been performed or the event has happened.** *Lane v. Coe*, 262 N.C. 8, 136 S.E.2d 269 (1964).

**A receipt for the cash payment on an identified tract of land belonging to an estate, signed by the executor, who is also an heir and authorized to act in the matter by the other heirs, is a sufficient memorandum of the contract to convey, signed by the party to be charged within the requirement of the statute of frauds.** *Lewis v. Allred*, 249 N.C. 486, 106 S.E.2d 689 (1959).

**Will Not Sufficient As Memorandum or Note of Contract.** — See *McCraw v. Llewellyn*, 256 N.C. 213, 123 S.E.2d 575 (1962).

The mere exercise of the statutory right to dispose of one's property at death is not of itself evidence that the disposition directed is compelled by a contractual obligation. *McCraw v. Llewellyn*, 256 N.C. 213, 123 S.E.2d 575 (1962).

**A promissory note for the purchase price** signed and given by the purchaser is not such a contract or memorandum thereof. *Burriss v. Starr*, 165 N.C. 657, 81 S.E. 929 (1914).

**The memorandum need not be contained in a single document** but may consist of several papers properly connected together. *Smith v. Joyce*, 214 N.C. 602, 200 S.E. 431 (1939); *Millikan v. Simmons*, 244 N.C. 195, 93 S.E.2d 59 (1956); *Elliott v. Owen*, 244 N.C. 684, 94 S.E.2d 833 (1956).

This section does not require all of the provisions of the contract to be set out in a single instrument. The memorandum required by this section is sufficient if the contract provisions can be determined from separate but related writings. *Hines v. Tripp*, 263 N.C. 470, 139 S.E.2d 545 (1965).

**Letters addressed to third party may be used** against the writer as a memorandum of it. Such writings are sufficient evidence of the contract to warrant the court in giving effect to it. *Mizell v. Burnett*, 49 N.C. 249 (1857); *Nicholson v. Dover*, 145 N.C. 18, 58 S.E. 444 (1907).

**Series of Letters Construed Together.**—A series of letters, telegrams or other papers, documents, etc., signed as required by this section, will be construed together, and when the contract appears to be complete, the omission in some of the writings will be supplied by the others. *Simpson v. Burnett County Lumber Co.*, 193 N.C. 454, 137 S.E. 311 (1927).

**As to Seal.**—The statute of frauds does not require a contract for the sale of land to be under the seal of the party to be charged. *Simmons v. Spruill*, 56 N.C. 9 (1856); *Stephens v. Midyette*, 161 N.C. 323, 77 S.E. 243 (1913).

A seal is not necessary to the validity of a lease regardless of the length of the term, and the common law, which did not require leases to be in writing, is in full force and effect, modified only by the requirement of this section that a lease of more than three years be in writing. *Moche v. Leno*, 227 N.C. 159, 41 S.E.2d 369 (1947).

**Receipts for principal and interest and for taxes**, in which no mention is made of any agreement by the person signing same to sell or convey land, are insufficient under the provisions of this section. *Chason*

*v. Marley*, 224 N.C. 844, 32 S.E.2d 652 (1945).

**The admissions of the parties in their pleadings** may stand for the writing. *Sandlin v. Kearney*, 154 N.C. 596, 70 S.E. 942 (1911).

**Mere Recital of Agreement in Pleading Is Not Waiver of Statute.**—A party is not estopped by his pleading from asserting the defense of the statute of frauds unless the pleading asserts the voidable contract as a necessary basis for the relief sought, and the mere recital of the parol agreement in the pleading does not adopt it or ratify it or waive the right to thereafter assert the statute in subsequent pleadings. *Davis v. Lovick*, 226 N.C. 252, 37 S.E.2d 680 (1946).

**Time of Making Memorandum.**—The written memorandum required by this section need not necessarily be made at the time of the agreement. Even if made thereafter, if otherwise good, it will be valid. *Mizell v. Burnett*, 49 N.C. 249 (1857); *McGee v. Blankenship*, 95 N.C. 563 (1886); *Winslow v. White*, 163 N.C. 29, 79 S.E. 258 (1913); *McCall v. Lee*, 182 N.C. 114, 108 S.E. 390 (1921); *Millikan v. Simmons*, 244 N.C. 195, 93 S.E.2d 59 (1956).

An agreement to extend an option to purchase land, made on the 13th of the month and reduced to writing and signed on the 15th, is enforceable between the parties as of the 13th. *Millikan v. Simmons*, 244 N.C. 195, 93 S.E.2d 59 (1956).

## B. The Signature.

**What Constitutes Signing.**—The signing of a paper writing or instrument is the affixing of one's name thereto with the purpose or intent to identify the paper or instrument, or to give it effect as one's act. *McCall v. Textile Industrial Institute*, 189 N.C. 775, 128 S.E. 349 (1925).

Although the place of the signature upon the writing of the party to be charged is immaterial, and such party need not necessarily "subscribe" the writing, yet there must be a writing in which such party must have put his name with the intention of signing it. Thus, where the plaintiff, the purchaser, gave for the purchase price a note to the defendant which was filled in by the latter payable to his own name, it was held that the note was not signed by the defendant, since filling in the note with his own name was not equivalent to signing it. *Burriss v. Starr*, 165 N.C. 657, 81 S.E. 929 (1914).

**Place of Signing.**—This section is satisfied when the writing contains the signature anywhere in the instrument. *Flowe v.*

Hartwick, 167 N.C. 448, 83 S.E. 841 (1914).

This section does not require that the memorandum of sale be "subscribed," it only requires that it be signed. Hence, the signing by the auctioneer of the name of the highest bidder on the side of a printed advertisement is a sufficient signing of the contract. *Devereux v. McMahon*, 108 N.C. 134, 12 S.E. 902 (1891); *Proctor v. Finley*, 119 N.C. 536, 26 S.E. 128 (1896).

**Mark Sufficient.**—When written by the party to be charged, a mark of an illiterate person is a sufficient signature to fulfill the requirement of the statute. *Devereux v. McMahon*, 108 N.C. 134, 12 S.E. 902 (1891).

**The phrase "the party to be charged"** does not necessarily refer to the vendor, it may refer to the vendee. The party to be charged, within the meaning of the section is the defendant in the action, whoever he may be. *Hall v. Misenheimer*, 137 N.C. 183, 49 S.E. 104 (1904).

In a suit for the specific performance of a contract to convey land the "party to be charged" is the vendor, and hence the contract must have been signed by him. The vendee does not fulfill the condition imposed on him to show that the statute has been complied with, by a writing by which he alone is bound. *Clegg v. Bishop*, 188 N.C. 564, 125 S.E. 122 (1924).

The "party to be charged" under this section is the one against whom the relief is sought; and if the contract is sufficient to bind him, he can be proceeded against, though the others could not be held because, as to them, the statute is not fully complied with. *Lewis v. Murray*, 177 N.C. 17, 97 S.E. 750 (1919).

Thus, a contract in writing to sell land, signed by the vendor is good against him, although the correlative obligation to pay the price is not in writing and cannot be enforced against the purchaser. *Mizell v. Burnett*, 49 N.C. 249 (1857).

The statute requires that the writing be signed by the party to be charged. So, if A contract in writing to sell land to B, the former's promise being in writing and signed, but the latter's not, A would be bound to perform, but B would not. *Mizell v. Burnett*, 49 N.C. 249 (1857); *Durham Consol. Land & Improvement Co. v. Guthrie*, 116 N.C. 381, 21 S.E. 952 (1895).

**Member of Corporation or Partner May Sign.**—Under the clause "or by some other person by him thereto lawfully authorized" a member of a corporation or a partner is a competent agent to sign for the corpora-

tion or partnership. *Neaves v. North State Mining Co.*, 90 N.C. 412 (1884).

**Signature of Agent.**—If signed by one who is proved or admitted by the principal to have been authorized as agent, it is a sufficient compliance with the statute if the agent sign his own name instead of that of his principal by him. *Hargrove v. Adcock*, 111 N.C. 166, 16 S.E. 16 (1892).

The name of the party to be charged may be signed by some other person under the express terms of this section. In *re Williams' Will*, 234 N.C. 228, 66 S.E.2d 902 (1951).

This section permits an agent to bind his principal, and the agent may do so by signing his name. *Hines v. Tripp*, 263 N.C. 470, 139 S.E.2d 545 (1965).

Where the agent is the one by whom the contract or the memorandum is signed, the authority of the agent to sign it for his principal need not have been given in writing. And even a subsequent ratification of an unauthorized signing will suffice. *Johnston v. Sikes*, 49 N.C. 70 (1856).

It is not necessary that the name of the principal or his relation to the transaction shall appear upon the writing itself or in the form of the signature. *Neaves v. North State Mining Co.*, 90 N.C. 412 (1884).

**Ordinance, Resolution or Vote.** — An ordinance, resolution or vote of a municipal corporation, accepting a lease or contract tendered, does not constitute a signing within the meaning of the statute. *Wade v. New Bern*, 77 N.C. 460 (1877).

### C. Statement of Consideration.

**Contract Must Fix the Price.** — A contract for the sale of land or any interest therein, must fix the price, and where it does not, plaintiff cannot establish by parol evidence a change as to one of the essential terms of the contract as this would open the door to "all the mischiefs which the statute was intended to prevent." *Harvey v. Linker*, 226 N.C. 711, 40 S.E.2d 202 (1946); *Shepherd v. Duke Power Co.*, 140 F. Supp. 27 (M.D.N.C. 1956).

**Whether oral or in writing,** the contract must have a consideration to support it. *Draughan v. Bunting*, 31 N.C. 10 (1848); *Stanly v. Hendricks*, 35 N.C. 86 (1851); *Combs v. Harshaw*, 63 N.C. 198 (1869); *Haun v. Burrell*, 119 N.C. 544, 26 S.E. 111 (1896). But if in writing, the consideration need not appear in the writing, and may be shown by parol. *Nichols v. Bell*, 46 N.C. 32 (1853); *Haun v. Burrell*, 119 N.C. 544, 26 S.E. 111 (1896); *Peele v. Powell*, 156 N.C. 553, 73 S.E. 234 (1911); *Bateman v. Hopkins*, 157 N.C. 470, 73 S.E. 133 (1911); *Lewis v. Murray*, 177



N.C. 17, 97 S.E. 750 (1919). But see *Hall v. Misenheimer*, 137 N.C. 183, 49 S.E. 104 (1904), where it is said that a memorandum of a contract for the sale of land is not good as against the vendee unless it shows the price to be paid.

#### Change of Purchase Price in Option.—

Where purchase price of land was changed in an option it constituted a new contract, unenforceable unless signed by the parties to be charged. *Harvey v. Linker*, 226 N.C. 711, 40 S.E.2d 202 (1946).

### IV. PART PERFORMANCE.

**In General.** — The doctrine which prevails in many states, that a part or even a full performance of the stipulation of an unwritten agreement for the disposition of an interest in land exempts such agreement from the operation of the statute of frauds, is not recognized in this State under this section which declares such agreements to be void and of no effect. *Ellis v. Ellis*, 16 N.C. 342 (1829); *Kivett v. McKeithan*, 90 N.C. 106 (1884); *Ebert v. Disher*, 216 N.C. 36, 3 S.E.2d 301 (1939). In such a case, however, the party who has advanced the purchase price or has made improvements shall be refunded his advances. *Kivett v. McKeithan*, supra; *Barnes v. Brown*, 71 N.C. 507 (1874); *Luton v. Badham*, 127 N.C. 96, 37 S.E. 143 (1900); *Smithdeal v. McAdoo*, 172 N.C. 700, 90 S.E. 907 (1916). But see the dissenting opinion of Judge Douglas, in *Luton v. Badham*, supra. See also *Albea v. Griffin*, 22 N.C. 9 (1838); *Dunn v. Moore*, 38 N.C. 364 (1844); *Plummer v. Owens*, 45 N.C. 254 (1853), where cases were held not within statute.

North Carolina has repudiated and consistently declined to follow the doctrine of part performance. *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962).

**The remedy of the promisee** who has rendered personal services in consideration of an oral contract to devise real estate void under the statute of frauds is an action on implied assumpsit or quantum meruit for the value of the services rendered. *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962).

Where the promisor in an oral contract to convey or devise real property has received the purchase price in money or other valuable consideration and has failed to transfer title, the promisee may recover the consideration in an action of quasi-contract for money had and received or under the doctrine of unjust enrichment. *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962).

**Permanent improvements made by the purchaser in possession** under an unenforceable contract to convey are sufficient claim of title to support a claim for betterments, and the statute of frauds may not be asserted to defeat such claim. *Pamlico County v. Davis*, 249 N.C. 648, 107 S.E.2d 306 (1959).

### V. PLEADING AND PRACTICE.

**A parol contract to sell or convey land may be enforced, unless the party to be charged takes advantage of the statute of frauds by pleading it, or by denial of the contract, as alleged, which is equivalent to a plea of the statute.** *Weant v. McCanless*, 235 N.C. 384, 70 S.E.2d 196 (1952).

**Three Modes of Taking Advantage of Statute.**—The party to be charged may take advantage of the statute by pleading the statute specifically, by denying the contract, or by alleging another and different contract. *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962).

**Defense Can Only Be Raised by Answer or Reply.**—The provisions of the statute of frauds cannot be taken advantage of by motion to strike. Such defense can only be raised by answer or reply. The statute of frauds may be taken advantage of in any one of three ways: (1) The contract may be admitted and the statute pleaded as a bar to its enforcement; (2) the contract, as alleged, may be denied and the statute pleaded, and in such case if it "develops on the trial that the contract is in parol, it must be declared invalid," or, (3) the party to be charged may enter a general denial without pleading the statute, and on the trial object to the admission of parol testimony to prove the contract. *Weant v. McCanless*, 235 N.C. 384, 70 S.E.2d 196 (1952).

The statute of frauds is an affirmative defense and must be pleaded. *Yeager v. Dobbins*, 252 N.C. 824, 114 S.E.2d 820 (1960).

An oral contract to convey or devise real property may be enforced unless the party to be charged takes advantage of the statute of frauds by pleading it. *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962).

**Complaint Good in Ejectment Independent of Contract Held Not to Estop Pleading Statute in Reply.**—Where plaintiff alleged that he was life tenant of realty and defendant, remainderman, was in possession under parol agreement to pay a stipulated sum yearly rental to the life tenant, with proviso that the amount should

be increased as his necessities might require, that he had demanded an increased rental which defendant had refused to pay, and that he had thereupon demanded possession and defendant admitted allegations except increase of rental, it was held that complaint was good in action in ejectment independently of rental contract, and plaintiff was not estopped from pleading the statute of frauds in his reply. *Davis v. Lovick*, 226 N.C. 252, 37 S.E.2d 680 (1946).

**Statute May Be Relied On under General Issue or General Denial.** — A party may rely on the statute of frauds under the general issue or a general denial. *Luton v. Badham*, 127 N.C. 96, 37 S.E. 143 (1900); *Winders v. Hill*, 144 N.C. 614, 57 S.E. 456 (1907); *Ebert v. Disher*, 216 N.C. 36, 3 S.E.2d 301 (1939).

It is settled law that a party may rely on the statute of frauds under a general denial. *Clapp v. Clapp*, 241 N.C. 281, 85 S.E.2d 153 (1954); *Riggs v. Anderson*, 260 N.C. 221, 132 S.E.2d 312 (1963).

Denial that an alleged oral agreement to devise real property was ever made invokes the statute of frauds as effectively as if it had been expressly pleaded. *Humphrey v. Faison*, 247 N.C. 127, 100 S.E.2d 524 (1957); *Hunt v. Hunt*, 261 N.C. 437, 135 S.E.2d 195 (1964).

A denial of the alleged contract suffices to require compliance with this section if plaintiff is to recover on the contract alleged. *McCraw v. Llewellyn*, 256 N.C. 213, 123 S.E.2d 575 (1962).

A defense of the statute of frauds may be taken advantage of by general denial. *Riggs v. Anderson*, 260 N.C. 221, 132 S.E.2d 312 (1963).

A denial of the contract as alleged is equivalent to a plea of the statute. *McCall v. Textile Industrial Institute*, 189 N.C. 775, 128 S.E. 349 (1925); *Ebert v. Disher*, 216 N.C. 36, 3 S.E.2d 301 (1939); *Humphrey v. Faison*, 247 N.C. 127, 100 S.E.2d 524 (1957); *Hunt v. Hunt*, 261 N.C. 437, 135 S.E.2d 195 (1964); *Hines v. Tripp*, 263 N.C. 470, 139 S.E.2d 545 (1965).

In a suit to enforce specific performance of an oral contract to convey land, the denial of the contract in the answer raises the defense of the statute of frauds. *Grady v. Faison*, 224 N.C. 567, 31 S.E.2d 760 (1944).

In an action on a contract to convey land, the defense being that the contract is not in writing as required by this section, the parties sought to be charged may simply deny the contract or plead the statute of frauds, or they may do both, and if

either plea is made good, the contract cannot be enforced. *Chason v. Marley*, 224 N.C. 844, 32 S.E.2d 652 (1945).

Denial of the contract as alleged is sufficient to raise the defense of the statute of frauds, since it places the burden upon plaintiff of establishing the contract by competent evidence, and if the contract be within the statute, the writing itself is the only competent evidence to prove its existence. *Jamerson v. Logan*, 228 N.C. 540, 46 S.E.2d 561 (1948); *Shepherd v. Duke Power Co.*, 140 F. Supp. 27 (M.D.N.C. 1956).

But see *Curtis v. Piedmont Lumber & Mining Co.*, 109 N.C. 401, 13 S.E. 944 (1891), where it is held that in an action on a contract for lumber the defendant in order to avail himself of the defense of the statute of frauds should plead it specifically.

**The statute of frauds cannot be taken advantage of by demurrer**, since that admits the contract. The contract is valid and binding unless the invalidity, by reason of the statute, is set up by the answer. *Hemmings v. Doss*, 125 N.C. 400, 34 S.E. 511 (1899); *Stevens v. Midyette*, 161 N.C. 323, 77 S.E. 243 (1913); *Weant v. McCannless*, 235 N.C. 384, 70 S.E.2d 196 (1952).

The provisions of this section may not be taken advantage of by demurrer. *McC Campbell v. Valdes Bldg. & Loan Ass'n*, 231 N.C. 647, 58 S.E.2d 617 (1950); *Yeager v. Dobbins*, 252 N.C. 824, 114 S.E.2d 820 (1960).

A party who claims protection from the statute must take affirmative action. He cannot avail himself of its provisions by demurrer. *Herring v. Volume Merchandise, Inc.*, 249 N.C. 221, 106 S.E.2d 197 (1958).

The defense of the statute of frauds to an oral agreement to secure a note by a mortgage on real estate cannot be raised by demurrer. *McKinley v. Hinnant*, 242 N.C. 245, 87 S.E.2d 568 (1955).

Procedurally, the defense of the statute of frauds cannot be taken advantage of by demurrer; it can only be raised by answer. This may be done in either of two ways: The defendant may plead the statute, in which case when it develops on the trial that the contract is in parol, it must be declared invalid; or the defendant may enter a general denial, and on trial may object to the parol evidence to establish the contract, which will be equally fatal to the maintenance of the action. *Embler v. Embler*, 224 N.C. 811, 32 S.E.2d 619 (1945).

**When Statute Is Pleaded, Parol Evi-**



**denance Is Incompetent.**—When the statute of frauds is specifically pleaded, testimony of a contract or promise to lease land exceeding in duration three years from making thereof, resting entirely in parol, is incompetent. *Wright v. Allred*, 226 N.C. 113, 37 S.E.2d 107 (1946).

**Defendant's failure to object to parol evidence** offered to show the existence of the contract is not a waiver of his defense of the statute of frauds, a fortiori if the evidence admitted without objection does not tend to show the existence of the contract but tends only to support a recovery on implied assumpsit, since the denial of the contract casts the burden on plaintiff to establish his cause of action by legal evidence. *Jamerson v. Logan*, 228 N.C. 540, 46 S.E.2d 561 (1948).

Where the pleadings raise the question of the statute of frauds, that defense is not waived by a failure to object to the parol evidence on the trial. *Pickelsimer v. Pickelsimer*, 257 N.C. 696, 127 S.E.2d 557 (1962).

**Burden of Showing Proper Memorandum.**—In a suit to enforce specific performance of a written memorandum allegedly given for the sale of a house and lot, the burden was on the plaintiff to show that the memorandum was executed in compliance with the statute of frauds. *Elliott v. Owen*, 244 N.C. 684, 94 S.E.2d 833 (1956).

**§ 22-3. Contracts with Cherokee Indians.**—All contracts and agreements of every description made with any Cherokee Indian, or any person of Cherokee Indian blood within the second degree, for an amount equal to ten dollars or more, shall be void, unless some note or memorandum thereof be made in writing and signed by such Indian or person of Indian blood, or some other person by him authorized, in the presence of two witnesses, who shall also subscribe the same: Provided, that this section shall not apply to any person of Cherokee Indian blood or any Cherokee Indian who understands the English language and who can speak and write the same intelligently. (R. C., c. 50, s. 16; Code, s. 1553; Rev., s. 975; 1907, c. 1004, s. 1; C. S., s. 989.)

**Section Must Be Availed Of Before Judgment.**—While, under this section, there may be defenses available against a contract, if they are not availed of before a judgment is rendered, the judgment is res adjudicata. *Rogers v. Kimsey*, 101 N.C. 559, 8 S.E. 159 (1888).

**§ 22-4. Promise to revive debt of bankrupt.**—No promise to pay a debt discharged by any decree of a court of competent jurisdiction, in any proceeding in bankruptcy, shall be received in evidence unless such promise is in writing and signed by the party to be charged therewith. (1899, c. 57; Rev., s. 978; C. S., s. 990.)

**Editor's Note.**—See 13 N.C.L. Rev. 60, for possible construction of this section.

Whether this section is applicable to a promise made subsequent to the filing of

**Record on Appeal.**—Where upon appeal, the insufficiency of letters to constitute a valid contract under this section is sought to be raised, the contents of the letters must appear upon the record. *Layton v. Godwin*, 186 N.C. 312, 119 S.E. 495 (1923).

**Issues as to title of land** cannot be shown by parol. *Cox v. Ward*, 107 N.C. 507, 12 S.E. 379 (1890); *Presnell v. Garrison*, 122 N.C. 595, 29 S.E. 839 (1898).

**Discharge by Matter in Pais.**—A written contract for the sale of land can be discharged by matter in pais. *Miller v. Pierce*, 104 N.C. 389, 10 S.E. 554 (1889).

**Where Complaint Alleges Consummated Agreement or Estoppel.**—Where, in lessor's action for possession of the premises, the allegations of the complaint are sufficient, liberally construed, to allege a consummated parol agreement by lessee to surrender the premises or equitable matters in pais sufficient to raise the question of estoppel of lessee and those claiming under him from denying the termination of the lease, lessor is entitled to show facts establishing such allegations, and judgment dismissing the action on the ground that the parol agreement to surrender the lease came within the statute of frauds and was void as a matter of law is error. *Herring v. Volume Merchandise, Inc.*, 249 N.C. 221, 106 S.E.2d 197 (1958).

**It Applies Where One or Both Parties Are Indians.**—This section applies as well where the contract is between two Indians as where one of the parties is white. *Lovingood v. Smith*, 52 N.C. 601 (1860); *State v. Ta-Cha-Na-Tah*, 64 N.C. 614 (1870).

a petition in bankruptcy but before the order of discharge is entered, quare. *Westall v. Jackson*, 218 N.C. 209, 10 S.E.2d 674 (1940).

## Chapter 23.

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## ARTICLE 1.

*Assignments for Benefit of Creditors.***§ 23-1. Debts mature on execution of assignment; no preferences.**

—Upon the execution of any voluntary deed of trust or deed of assignment for the benefit of creditors, all debts of the maker thereof shall become due and payable at once, and no such deed of trust or deed of assignment shall contain any preferences of one creditor over another, except as hereinafter stated. (1893, c. 453; Rev., s. 967; 1909, c. 918, s. 1; C. S., s. 1609.)

**Cross References.**—As to homestead and exemptions, see § 1-369 et seq. and notes thereto. As to preferences in the absence of assignment, see note to § 39-15, analysis line II, A.

**What Constitutes an Assignment.**—The Supreme Court has held that where a person who is insolvent makes an assignment of practically all his property to secure a pre-existing debt, there being also other creditors, such instrument will be treated as an assignment for the benefit of creditors and subject to the statutes relating thereto, and neither the omission of a small part of the debtor's property nor a defeasance clause in the instrument will change this result. *National Bank v. Gilmer*, 116 N.C. 684, 22 S.E. 2 (1895); *National Bank v. Gilmer*, 117 N.C. 416, 23 S.E. 333 (1895); *Glanton v. Jacobs*, 117 N.C. 427, 23 S.E. 335 (1895); *Cooper v. McKinnon*, 122 N.C. 447, 29 S.E. 417 (1898); *Pearre v. Folb*, 123 N.C. 239, 31 S.E. 475 (1898); *Brown v. Nimocks*, 124 N.C. 417, 32 S.E. 743 (1899); *Taylor v. Lauer*, 127 N.C. 157, 37 S.E. 197 (1900); *Odom v. Clark*, 146 N.C. 544, 60 S.E. 513 (1908); *Powell Bros. v. McMullan Lumber Co.*, 153 N.C. 52, 68 S.E. 926 (1910); *Farmers Banking & Trust Co. v. Tarboro Leaf Tobacco Co.*, 188 N.C. 177, 124 S.E. 158 (1924).

**Same—Deed to Secure Advancements.**—Where the purpose of a deed is to secure payment not only of pre-existing debts but also of debts to be contracted for advancements to aid grantors in carrying on their business, then said deed is not a voluntary deed of assignment for the benefit of creditors, within the meaning of this article. *Commissioner of Banks v. Turnage*, 202 N.C. 485, 163 S.E. 451 (1932).

**Same—Mortgage.**—Where a mortgage is made of the entirety of a large estate for pre-existing debts (omitting only in an insignificant remnant of property), the mortgage is in effect an assignment for the benefit of creditors secured therein. *National Bank v. Gilmer*, 116 N.C. 684, 22 S.E. 2 (1895); *National Bank v. Gilmer*, 117 N.C. 416, 23 S.E. 333 (1895).

A chattel mortgage, attempted to be exe-

cuted by an insolvent corporation owing other creditors, to secure a pre-existing debt on practically all of its property, will be treated as an assignment and void, unless the requirements of the statute have been complied with, and no lien otherwise on the property described therein can be thereby created. *Farmers Banking & Trust Co. v. Tarboro Leaf Tobacco Co.*, 188 N.C. 177, 124 S.E. 158 (1924).

But a chattel mortgage on a stock of goods, securing the purchase price, cannot be deemed an assignment for the benefit of creditors where the secured debt is contemporaneous with the contract of purchase, as a part of one continuous transaction. *Cowan v. Dale*, 189 N.C. 684, 128 S.E. 155 (1925).

A chattel mortgage of an insolvent corporation, executed and registered before the appointment of a receiver for it, will not be construed under the provisions of this section as in effect an assignment for the benefit of creditors in the absence of the fact that the property covered by the mortgage constitutes practically all of the property of the insolvent. *Vanderwal v. Vanco Dairy Co.*, 200 N.C. 314, 156 S.E. 512 (1931).

**By Whom Made—Corporations.**—A corporation, through its proper officers, may make an assignment for the benefit of creditors. *Potts v. Wallace*, 146 U.S. 689, 13 Sup. Ct. 196, 36 L. Ed. 1135 (1892).

**Same — Partnerships.**—In *Tracy v. Tuffly*, 134 U.S. 206, 10 Sup. Ct. 527, 33 L. Ed. 879 (1890), it is held that a partnership, whether general or limited, may, through its proper officers, make an assignment for the benefit of creditors.

**Same—Trustees.**—In accordance with the rule that trustees must unite to pass any title to property jointly held by them, where there are two or more trustees of the property of insolvents, all should join therein. *Wilber v. Almy*, 53 U.S. (12 How.) 180, 13 L. Ed. 944 (1851).

**Provision as to Maturity of Debts Applies to Sureties.**—The provision that all debts of the maker become due at once applies to the sureties upon a note of the



assignor. *Pritchard v. Mitchell*, 139 N.C. 54, 51 S.E. 783 (1905).

**Effect of Void Assignment.**—If a deed of assignment for the benefit of creditors becomes void as to creditors, its primary and essential purpose is defeated, and it is totally invalid. The assignee does not take the property for his own benefit, but for the benefit of the creditors, and while he holds the legal title, they are really the equitable owners to the extent of their claims. Whatever defeats their interest defeats the object of the trust and, consequently, the trust itself. *Cooper v. McKinnon*, 122 N.C. 447, 29 S.E. 417 (1898).

**Same—Fraud Need Not Be Shown.**—A voluntary conveyance, declared invalid for not complying with the provisions of this article, is not only void as to bona fide unsecured creditors, but inter partes; and hence it would be unnecessary for such creditors to show fraud in its procurement in order to set it aside. *Powell Bros. v. McMullan Lumber Co.*, 153 N.C. 52, 68 S.E. 926 (1910).

**Assignment Omitting Creditors Is Preference.**—An assignment for the benefit of

creditors, omitting certain other creditors, is invalid as a preference. *Taylor v. Lauer*, 127 N.C. 157, 37 S.E. 197 (1900).

**Effect of Subsequent Bankruptcy.**—Where an assignment for the benefit of creditors was made under this section more than four months before the debtor was adjudged a bankrupt under the federal law, the assignment was valid and whatever was done under it was valid. The court of bankruptcy cannot take retroactive cognizance of trusts beyond four months and, hence, will merely administer the estate as it exists at the time of the adjudication. *In re Carver*, 113 Fed. 138 (E.D.N.C. 1902).

**Assignment Is Irrevocable.**—It has been held in *Barings v. Dabney*, 86 U.S. (19 Wall.) 1, 22 L. Ed. 90 (1873), that a voluntary assignment for the benefit of creditors, if assented to by the creditors, or a considerable portion of them, becomes irrevocable.

**Quoted in Mascot Stove Mfg. Co. v. Turnage**, 183 N.C. 137, 110 S.E. 779 (1922).

**§ 23-2. Trustee to file schedule of property.**—Upon the execution of such deed of trust, the trustee, whether named therein or appointed as hereafter provided for, shall file with the clerk of the superior court of the county in which said deed of trust is registered, within ten days after the registration thereof, an inventory under oath, giving a complete, full and perfect account of all property that has come into his hands or to the hands of any person for him, by virtue of such deed of trust, and when further property of any kind not included in any previous return comes to the hands or knowledge of such trustee he shall return the same as hereinbefore prescribed within ten days after the possession or discovery thereof. (1893, c. 453, s. 2; Rev., s. 968; C. S., s. 1610.)

**Assignment Is Void Unless Section Complied with.**—An assignment for the benefit of creditors is void unless the formalities of this section are complied with as to filing an inventory of the property, and will be set aside at the suit of a creditor whose debt is not therein provided for. *Odom v. Clark*, 146 N.C. 544, 60 S.E. 513 (1908).

If the provisions of this section are not complied with, the deeds of trust are void. *Virginia Trust Co. v. Pharr Estates*, 206 N.C. 894, 175 S.E. 186 (1934).

**Cited in Flowers v American Agricultural Chem. Co.**, 199 N.C. 456, 154 S.E. 736 (1930).

**§ 23-3. Trustee to recover property conveyed fraudulently or in preference.**—It is the duty of the trustee to recover, for the benefit of the estate, property which was conveyed by the grantor or assignor in fraud of his creditors, or which was conveyed or transferred by the grantor or assignor for the purpose of giving a preference. A preference, under this section, shall be deemed to have been given when property has been transferred or conveyed within four months next preceding the registration of the deed of trust or deed of assignment in consideration of the payment of a pre-existing debt, when the grantee or transferee of such property knows or has reasonable ground to believe that the grantor or assignor was insolvent at the time of making such conveyance or transfer. (1909, c. 918, s. 2; C. S., s. 1611.)

**Editor's Note.**—For a discussion of preference under the Bankruptcy Act, see Wil-

son v. Taylor, 154 N.C. 211, 70 S.E. 286 (1911).



**Purpose of Section Is to Avoid Certain Preferences.**—On proper consideration of this section, its terms and purpose, it is clear that the legislature intended to prohibit and avoid, as a wrongful preference, any and every disposition of real or personal property, absolute or conditional, by which a creditor, in consideration of an existent or antecedent debt and within four months of a general assignment by his debtor, acquires title to such debtor's property or any interest therein or lien thereon, when he knew or had reasonable ground to believe that his grantor or assignor was insolvent at the time the transfer or conveyance was made. *Wooten v. Taylor*, 159 N.C. 604, 76 S.E. 11 (1912); *Teague v. Howard Grocery Co.*, 175 N.C. 195, 95 S.E. 173 (1918).

**Preferences Were Valid at Common Law.**—A debtor unable to pay his indebtedness in full has an undoubted right, in the absence of a statute, to make preferences in the distribution of his property among the creditors, when the appropriation is absolute and with no reservation for his own benefit to the injury of creditors unprovided for. *Guggenheimer v. Brookfield*, 90 N.C. 232 (1884).

At common law a debtor may, in the exercise of the power arising from the ownership of property, if acting conscientiously and without collusion, prefer certain of his creditors to the detriment or exclusion of the others. *United States Rubber Co. v. American Oak Leather Co.*, 181 U.S. 434, 21 Sup. Ct. 670, 45 L. Ed. 938 (1901).

**Real and Personal Property Included in Section.**—This section requiring the trustee in a general assignment for creditors to recover property "conveyed or transferred by the grantor or assignor" in preference, within the four months' period, includes within its meaning both real and personal property, and the general methods by which the title is passed or interest therein created, and extends to an executed contract of sale. *Teague v. Howard Grocery Co.*, 175 N.C. 195, 95 S.E. 173 (1918).

**Commencement of Four Months' Period.**—The four months' period mentioned in this section is to be counted from the time the transfer or conveyance was made, and not from the time of its registration. *Wooten v. Taylor*, 159 N.C. 604, 76 S.E. 11 (1912).

**Conveyance by Solvent Debtor Is Not Preference.**—Where a solvent debtor conveys practically all of his property to secure a pre-existing debt, having other creditors at the time, it does not create a

preference within the intent and meaning of this section. *Flowers v. American Agricultural Chem. Co.*, 199 N.C. 456, 154 S.E. 736 (1930).

**Meaning of "Insolvent."** — "Insolvent" means unable to meet liabilities after converting all of the property or assets belonging to the person or estate into money, at market prices, and applying the proceeds, with the cash previously on hand, to the payment of them. *Silver Valley Mining Co. v. North Carolina Smelting Co.*, 119 N.C. 417, 25 S.E. 954 (1896).

**Same—Applied to Corporation.**—A corporation is not insolvent, so as to render a mortgage of its property fraudulent, so long as it has property sufficient, if converted into money at market prices, to meet its liabilities. *Silver Valley Mining Co. v. North Carolina Smelting Co.*, 119 N.C. 417, 25 S.E. 954 (1896).

**Preference Is Recoverable although Deed of Assignment Is Made Subject Thereto.**—A deed of general assignment for the benefit of creditors, by expressly being made subject to a prior mortgage of the grantor's property, wherein an unlawful preference is given, will not, of itself, prevent a recovery of the property conveyed in the mortgage by the trustee in the deed in trust for the general creditors. *Wooten v. Taylor*, 159 N.C. 604, 76 S.E. 11 (1912).

**Purchase-Money Mortgage Is Not Preference.**—A chattel mortgage on a stock of goods to secure the purchase price, the mortgagor retaining possession, is not a preference within this section. *Cowan v. Dale*, 189 N.C. 684, 128 S.E. 155 (1925).

**Nor Is Judgment against Debtor.**—A judgment duly rendered by a court of competent jurisdiction against a debtor assigning his property to a trustee for the benefit of creditors is not a transfer or conveyance of property by the assignor, although the judgment is rendered within four months prior to the assignment to the trustee, and the judgment is not a preference prohibited by this section, and will not be declared void upon suit of the trustee. *Pritchett v. Tolbert*, 210 N.C. 644, 188 S.E. 71 (1936).

**Thus, Execution Levied Prior to Registration of Deed of Assignment Creates Prior Lien.**—Where a valid judgment is rendered within four months prior to an assignment for benefit of creditors by the judgment debtor, and execution is issued thereon and personal property of the debtor levied upon prior to the registration of the deed of assignment, the judgment is a lien upon the personal property levied upon prior to the title of the trustee in the

deed of assignment. *Pritchett v. Tolbert*, 210 N.C. 644, 188 S.E. 71 (1936).

**Assignees Have Right and Duty to Defend Suits.**—It is the duty of assignees for the benefit of creditors, who have once accepted the trust, not only to appear, but

so far as the nature of the transaction and the facts and circumstances of the case will admit or warrant, to defend suits to set aside the assignments. *Chittenden v. Brewster*, 69 U.S. (2 Wall.) 191, 17 L. Ed. 839 (1864).

**§ 23-4. Substitute for incompetent trustee appointed in special proceeding.**—When a trustee named in a deed of assignment for the benefit of creditors has died or resigned or has in any way become incompetent to execute the trust, the clerk of the superior court of the county wherein said deed of assignment has been registered is authorized and empowered, in a special proceeding in which all persons interested have been made parties, to appoint some discreet and competent person to act as such trustee and to execute all the trusts created in the original deed of assignment, according to its true intent and as fully as if originally appointed trustee therein. (1915, c. 176, s. 1; C. S., s. 1612.)

**Cross Reference.**—As to appointment of successor to incompetent trustee, see § 45-9.

**§ 23-5. Insolvent trustee removed unless bond given; substitute appointed.**—Upon the complaint of any creditor of the assignor or trustee in such deed of trust, alleging under oath that the trustee named therein is insolvent, and asking that he be required to give bond or be removed, it is the duty of the clerk of the superior court of the county in which such deed of trust is registered, upon a notice of not more than ten days to such trustee, to hear the complaint. If upon such hearing the clerk is satisfied that such trustee is insolvent, he shall remove such trustee and appoint some competent person to execute the provisions of such deed of trust, unless such insolvent trustee shall file with the clerk a good and sufficient bond, to be approved by him, in a sum double the value of the property in the deed of trust, payable to the State of North Carolina, and conditioned that such trustee shall faithfully execute and carry into effect the provisions of said deed of trust. (1893, c. 453, s. 3; Rev., s. 969, C. S., s. 1613.)

**Section Throws Greater Safeguards around Assignments.**—While formerly it was entirely competent for a debtor to assign his property to an insolvent person who was otherwise qualified to execute the provisions of the deed of trust for the benefit of creditors, the policy of the law

has since been declared by this section to throw greater safeguards around such transactions by requiring every trustee of this kind to give bond when proper application for that purpose is made to the clerk. *Preiss v. Cohen*, 112 N.C. 278, 17 S.E. 520 (1893).

**§ 23-6. Trustee removed on petition of creditors; substitute appointed.**—Upon the written petition of one-fourth of the number of the creditors of the grantor or assignor whose claims aggregate more than fifty per cent of the total indebtedness of said grantor or assignor, the clerk of the superior court of the county in which said deed of trust or deed of assignment is registered, upon a notice of not more than ten days to said trustee of said petition, shall remove said trustee and appoint some competent person to execute the provisions of such deed of trust or deed of assignment. (1909, c. 918, s. 3; C. S., s. 1614.)

**§ 23-7. Substituted trustee to give bond.**—Upon the removal or resignation of any trustee it is the duty of the clerk to require the person appointed to execute the provisions of such deed of trust, before entering upon his duties, to file with the clerk a good and sufficient bond, to be approved by him in a sum double the value of the property in said deed of trust, payable to the State of North Carolina, and conditioned that such person shall faithfully execute and carry into effect the provisions of said deed of trust. (1893, c. 453, s. 3; Rev., s. 970; 1909, c. 918, s. 4; 1915, c. 176, s. 2; C. S., s. 1615.)

**§ 23-8. Only perishable property sold within ten days of registration.**—It is unlawful for any trustee, whether named in such deed of trust or appointed by a clerk of the superior court, to sell any part of the property described in such deed of trust within ten days from the registration thereof, unless such property or some part thereof be perishable, in which case he may sell such property as is perishable, according to the powers conferred upon him in said deed of trust. (1893, c. 453, s. 4; Rev., s. 971; C. S., s. 1616.)

**§ 23-9. Creditors to file verified claims with clerk; false swearing misdemeanor.**—All creditors of the maker of such deed of trust shall, before receiving payment of any amount from the said trustee, file with the clerk of the superior court a statement under oath that the amount claimed by him is justly due, after allowing all credits and offsets, to the best of his knowledge and belief. Any creditor who shall knowingly swear falsely in such statement shall be guilty of a misdemeanor. (1893, c. 453, ss. 6, 7; Rev., ss. 972, 3617; C. S., s. 1617.)

**Creditors Claiming under Deed Cannot Impeach It.**—Creditors, who claim under a deed of trust and file their claims to share in the proceeds of sale, cannot be heard to impeach its provisions. *Chard v. Warren*, 122 N.C. 75, 29 S.E. 373 (1898).

**§ 23-10. Priority of payments by trustee.**—The trustee, after paying the necessary costs of the administration of the trust, shall pay as speedily as possible

- (1) All debts which are a lien upon any of the trust property in his hands, to the extent of the net proceeds of the property upon which such debt is a lien;
- (2) Wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before registration of said deed of trust or deed of assignment, and
- (3) All other debts equally ratable. (1909, c. 918, s. 5; C. S., s. 1618.)

**No Discrimination Except as Provided.**—Except for the two classes mentioned in this section, all discrimination among creditors is forbidden. *Wooten v. Taylor*, 159 N.C. 604, 76 S.E. 11 (1912).

**Section Does Not Authorize Preference to Clerks on Appointment of Receiver.**—See *Mascot Stove Mfg. Co. v. Turnage*, 183 N.C. 137, 110 S.E. 779 (1922).

**§ 23-11. Trustee to account quarterly; final account in twelve months.**—The trustee, whether named in the deed of trust or appointed by a clerk of a superior court, shall within three months from the registration of such deed of trust, and at each succeeding period of three months, file with the clerk of the superior court of the county in which the same is registered an account under oath, stating in detail his receipts and disbursements and his action as trustee, and within twelve months he shall file his final account of his administration of his trust. The clerk may upon good cause shown extend the time within which the quarterly and final accounts herein provided for are to be filed. (1893, c. 453, s. 5; Rev., s. 973; C. S., s. 1619.)

**§ 23-12. Trustee violating duties guilty of misdemeanor.**—If any trustee in a deed of trust for the benefit of creditors shall fail to file his inventory as required by law, or shall knowingly make any false statement in such inventory, or shall knowingly fail to include any property therein, or shall sell any part of the property described in the deed of trust within ten days unless such property so sold be perishable, or shall fail to file either of the quarterly accounts or the final accounts as required by law, or shall knowingly make any false statement in such quarterly or final account, or shall knowingly fail to include any property, money or disbursement in such quarterly or final account, he shall, in either case, be guilty of a misdemeanor. (1893, c. 453, s. 8; Rev., s. 3689; C. S., s. 1620.)



## ARTICLE 2.

*Petition of Insolvent for Assignment for Creditors.*

§ 23-13. **Petition; schedule; inventory; affidavit.** — Every insolvent debtor may present a petition in the superior court, praying that his estate may be assigned for the benefit of all his creditors, and that his person may thereafter be exempt from arrest or imprisonment on account of any judgment previously rendered or of any debts previously contracted. On presenting such petition, every insolvent shall deliver therewith a schedule containing an account of his creditors and an inventory of his estate, which inventory shall contain—

- (1) A full and true account of his creditors, with the place of residence of each, if known, and the sum owing to each creditor, whether on written security, on account, or otherwise.
- (2) A full and true inventory of his estate, real and personal, with the encumbrances existing thereon, and all books, vouchers and securities relating thereto.
- (3) A full and true inventory of all property, real and personal, claimed by him as exempt from sale under execution.

He shall annex to his petition and schedule the following affidavit, which must be taken and subscribed by him before the clerk of the superior court, and must be certified by such officer:

I, . . . . ., do swear (or affirm) that the account of my creditors, with the places of their residence, and the inventory of my estate, which are herewith delivered, are in all respects just and true; that I have not at any time or in any manner disposed of or made over any part of my estate for the future benefit of myself or my family, or in order to defraud any of my creditors; and that I have not paid, secured to be paid, or in any way compounded with any of my creditors, with a view that they, or any of them, should abstain or desist from opposing my discharge: so help me, God. (1868-9, c. 162, ss. 1, 2, 3; Code, ss. 2942, 2943, 2944; Rev., s. 1930; C. S., s. 1621.)

**Cross References.** — As to prohibiting imprisonment for debt, see N.C. Const., Art. I, §§ 16, 17. As to provisional remedy of arrest, see § 1-409 et seq. See also § 1-311, as to execution against the person.

**Debtor Must Show Compliance.** — To avail himself of this article, a petitioner not under arrest must show that he has complied with the provisions of this article and obtained an order of discharge under §§ 23-15, 23-16. *Howie v. Spittle*, 156 N.C. 180, 72 S.E. 207 (1911).

**Debtor Should Set Out Facts as to Property Interest.**—Defendant having filed the schedule of his property, it was not

only proper, but necessary, that he should set out the facts showing what right, title, estate and interest he held in the real estate. *Edwards v. Sorrell*, 150 N.C. 712, 64 S.E. 898 (1909).

**Defendant in Alienation Suit May Have Benefit of Section.**—A suit by one charging the defendant with alienating the affections of his wife, and arresting and holding him for bail under the affidavits required, is one entitling the defendant to the benefit of this section for the relief of insolvent debtors. *Edwards v. Sorrell*, 150 N.C. 712, 64 S.E. 898 (1909).

§ 23-14. **Clerk to give notice of petition.**—On receiving the petition, schedule and affidavit, the clerk of the superior court shall make an order requiring all the creditors of such insolvent to show cause before said officer, within thirty days after publication of the order, why the prayer of the petitioner should not be granted, and shall post a notice of the contents of the order at the courthouse door and three other public places in the county where the application is made for four successive weeks; or, in lieu thereof, shall publish the same for three successive weeks in any newspaper published in said county, or in an adjoining county. (1868-9, c. 162, ss. 4, 5; Code, ss. 2945, 2946; Rev., s. 1931; C. S., s. 1622.)



**§ 23-15. Order of discharge and appointment of trustee.**—If no creditor oppose the discharge of the insolvent, the clerk of the superior court before whom the hearing of the petition is had shall enter an order of discharge and appoint a trustee of all the estate of such insolvent. (1868-9, c. 162, s. 6; Code, s. 2947; Rev., s. 1932; C. S., s. 1623.)

**§ 23-16. Terms and effect of order of discharge.**—The order of discharge shall declare that the person of such insolvent shall forever thereafter be exempted from arrest or imprisonment on account of any judgment, or by reason of any debt due at the time of such order, or contracted for before that time, though payable afterwards. But no debt, demand, judgment or decree against any insolvent, discharged under this chapter, shall be affected or impaired by such discharge, but the same shall remain valid and effectual against all the property of such insolvent acquired after his discharge and the appointment of a trustee; and the lien of any judgment or decree upon the property of such insolvent shall not be in any manner affected by such discharge. (1868-9, c. 162, s. 9; Code, s. 2950; Rev., s. 1933; C. S., s. 1624.)

**Cross References.** — As to prohibiting imprisonment for debt, see N.C. Const., Art. I, §§ 16, 17. As to execution against the person, see § 1-311. As to provisional remedy of arrest, see § 1-409 et seq.

**This section protects from future arrests** for the same debt such as have surrendered their property. *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891).

**But after-acquired property may be subject to execution and sale**, in proper cases. *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891). See also *Brown v. Long*, 22 N.C. 138 (1838), which holds that the subsequently acquired property of a discharged debtor may be reached in equity.

**§ 23-17. Suggestion of fraud by opposing creditor.** — Every creditor opposing the discharge of the insolvent may suggest fraud and set forth the particulars thereof in writing, verified by his oath; but the insolvent shall not be compelled to answer the suggestions of fraud in more than one case, though as many creditors as choose may make themselves parties to the issues in such cases. (1868-9, c. 162, s. 7; Code, s. 2948; Rev., s. 1934; C. S., s. 1625.)

**Suggestion of Fraud in Bastardy Proceeding.**—A mother of a bastard child, to whom an allowance has been made in bastardy proceedings, is such a creditor of the father of her child as to permit her to oppose the insolvent's discharge by suggesting fraud in answer to his petition. *State v. Parsons*, 115 N.C. 730, 20 S.E. 511 (1894).

**Same—As to Fine and Costs.** — When defendant in bastardy proceedings has been ordered to pay a fine and costs and allowance to the mother, only the State can suggest fraud as to the fine and costs. *State v. Parsons*, 115 N.C. 730, 20 S.E. 511 (1894).

**Answer Held Not to Suggest Fraud.**—One who has another arrested and held to bail for alienating the affections of his wife does not raise an issue or suggestion of fraud under this section by answering the petition for discharge, and denying a statement therein made by petitioner that he

is advised by counsel that, owing to the condition of the title to certain lands scheduled, an execution could not issue against it, as such statement is surplusage. *Edwards v. Sorrell*, 150 N.C. 712, 64 S.E. 898 (1909).

**All Creditors May Be Required to Join in One Issue.**—Where a debtor is arrested under different ca. sa.'s at the instance of several creditors, if he applies for his discharge as an insolvent debtor, and fraud is suggested in answer to his application, he has a right to require that all the creditors he may notify shall join in the trial of one issue, and the court will so direct. *Williams v. Floyd*, 27 N.C. 649 (1845).

**But this is for the ease of the debtor, and he may waive the privilege** by joining issue with each creditor, and then a verdict in his favor in one case will not discharge him from the responsibility in the case of another creditor. *Williams v. Floyd*, 27 N.C. 649 (1845).

## ARTICLE 3.

*Trustee for Estate of Debtor Imprisoned for Crime.*

§ 23-18. **Persons who may apply for trustee for imprisoned debtor.**—When any debtor is imprisoned in the penitentiary for any term, or in a county jail for any term more than twelve months, application by petition may be made by any creditor, the debtor, or by his wife, or any of his relatives, for the appointment of a trustee to take charge of the estate of such debtor. (1868-9, c. 162, s. 40; Code, s. 2974; Rev., s. 1943; C. S., s. 1626.)

§ 23-19. **Superior court appoints; copy of sentence to be produced.**—The application must be made to the superior court of the county where the debtor was convicted, and upon producing a copy of the sentence of such debtor, duly certified by the clerk of the court, together with an affidavit of the applicant that such debtor is actually imprisoned under such sentence, and is indebted in any sum, the clerk or the judge may immediately appoint a trustee of the estate of such debtor. (1868-9, c. 162, ss. 41, 42; Code, s. 2975; Rev., s. 1944; C. S., s. 1627.)

§ 23-20. **Duties of trustee; accounting; oath.**—The trustee of the imprisoned debtor shall pay his debts pro rata. After paying such debts, the trustee shall apply the surplus, from time to time, to the support of the wife and children of the debtor, under the direction of the superior court. When the imprisoned debtor is lawfully discharged from his imprisonment, the trustee shall deliver to him all the estate, real and personal, of such debtor, after retaining a sufficient sum to satisfy the expenses incurred in the execution of the trust and lawful commissions therefor. The trustee shall make his returns and have his accounts audited and settled by the clerk of the superior court of the county where the proceeding was had, in like manner as provided for personal representatives. Before proceeding to the discharge of his duty, the trustee shall take and subscribe an oath, well and truly to execute his trust according to his best skill and understanding. The oath must be filed with the clerk of the superior court. (1868-9, c. 162, ss. 43, 45, 46; Code, ss. 2976, 2978, 2979; Rev., ss. 1945, 1946, 1947; C. S., s. 1628.)

§ 23-21. **Court may appoint several trustees.**—The court has power, when deemed necessary, to appoint more than one person trustee under this chapter; but in reference to the rights, authorities and duties conferred herein, all such trustees shall be deemed one person in law. (1868-9, c. 162, s. 47; Code, s. 2980; Rev., s. 1948; C. S., s. 1629.)

§ 23-22. **Court may remove trustee and appoint successor.**—In case of the death, removal, resignation or other disability of a trustee, the court making the appointment may from time to time supply the vacancy; and all proceedings may be continued by the successor in office in like manner as in the first instance. (1868-9, c. 162, s. 48; Code, s. 2981; Rev., s. 1949; C. S., s. 1630.)

## ARTICLE 4.

*Discharge of Insolvent Debtors.*

§ 23-23. **Insolvent debtor's oath.**—Prisoners in order to be entitled to discharge from imprisonment under the provisions of this article shall take the following oath:

I, . . . . ., do solemnly swear (or affirm) that I have not the worth of fifty dollars in any worldly substance, in debts, money or otherwise whatsoever, and that I have not at any time since my imprisonment or before, directly or

indirectly, sold or assigned, or otherwise disposed of, or made over in trust for myself or my family, any part of my real or personal estate, whereby to have or expect any benefit, or to defraud any of my creditors: so help me, God. (1773, c. 100, s. 1, P. R.; 1808, c. 746, s. 2, P. R.; 1810, cc. 797, 802, P. R.; 1830, c. 33; 1838, c. 23; 1840, cc. 33, 34; 1852, c. 49; R. C., c. 59, s. 1; 1868-9, c. 162, s. 31; 1881, c. 76; Code, s. 2972; Rev., s. 1918a; C. S., s. 1631.)

**Constitutionality.** — This section does not contravene the constitutional provision in regard to homestead and personal property exemptions, as the prisoner can discharge himself from custody by paying the fine and costs or by complying with the provisions of this article and taking the oath prescribed. *State v. Williams*, 97 N.C. 414, 2 S.E. 370 (1887).

**Liberal Construction.** — In *Wood v. Wood*, 61 N.C. 538 (1868), it is stated that chapter 59 of the Revised Code (the provisions of which are contained in this article) has always received a liberal interpretation.

**§ 23-24. Persons imprisoned for nonpayment of costs in criminal cases.**—The following persons may be discharged from imprisonment upon complying with this article and § 153-194:

Every person committed for the fine and costs of any criminal prosecution. (1773, c. 100, s. 1, P. R.; 1808, c. 746, s. 2, P. R.; 1810, cc. 797, 802, P. R.; 1830, c. 33; 1838, c. 23; 1840, cc. 33, 34; 1852, c. 49; R. C., c. 59, s. 1; 1868-9, c. 162, s. 26; Code, s. 2967; Rev., s. 1915; C. S., s. 1632; 1933, c. 228, s. 9.)

**Purpose of Section.**—This section was manifestly intended to be construed as permitting a defendant convicted in a criminal proceeding, or found to be the father of a bastard child, to file a petition before the clerk designating the time when he wished to apply for a discharge. *State v. Parsons*, 115 N.C. 730, 20 S.E. 511 (1894).

**Construed with §§ 153-191 and 153-194.**—This section does not repeal those enacted much later (§§ 153-191, 153-194), but the latter modify it. All three sections being re-enacted into the Revisal at the same time, they must be construed together. *State v. Morgan*, 141 N.C. 726, 53 S.E. 142 (1906).

**Person Committed for Fine and Costs May Be Discharged.**—One committed for the fine and costs of a criminal prosecution, after remaining in jail twenty days, may be discharged upon complying with provisions of § 23-25. *State v. Davis*, 82 N.C. 610 (1880).

**Debtor Must Follow Provisions.**—When a person is taken by authority of an execution against his person by virtue of the provisions of § 1-311, he can be discharged from imprisonment only by payment or giving notice and surrender of all his property in excess of fifty dollars as provided in this section and §§ 23-30 through 23-38. *Allred v. Graves*, 261 N.C. 31, 134 S.E.2d 186 (1964).

**Cited in** *Moorefield v. Roseman*, 198 N.C. 805, 153 S.E. 399 (1930).

**And this is so, although a workhouse has been established** by the county commissioners in accordance with the provisions of § 153-209. *State v. Williams*, 97 N.C. 414, 2 S.E. 370 (1887).

**Where Prisoner Was Found Guilty on Three Indictments.**—There were three indictments against a prisoner to one of which he pleaded guilty, and judgment was suspended on the payment of costs, and he was found guilty on the other two, on one of which he was sentenced to imprisonment for ten days. After remaining in jail for the term of his imprisonment and twenty days additional, the prisoner took the oath prescribed and applied for his discharge; it was held, that he was entitled to his discharge in all three cases. *State v. McNeely*, 92 N.C. 829 (1885).

**Quoted in** *State v. Bryant*, 251 N.C. 423, 111 S.E.2d 591 (1959).

**Cited in** *State v. Bradshaw*, 214 N.C. 5, 197 S.E. 564 (1938).

**§ 23-25. Petition; before whom; notice; service.**—Every such person, having remained in prison for twenty days, may apply by petition to the court where the judgment against him was entered, praying to be brought before such court at a time and place to be named in the petition, and to be discharged upon taking the oath hereinbefore prescribed. The applicant shall cause ten days' notice of the time and place of filing the petition to be served on the sheriff or other officer by whom he was committed. In cases of conviction before a justice



of the peace the clerk of the superior court of the county where the convicted person confined for costs is, may administer the oath and discharge the prisoner. (1773, c. 100, s. 1, P. R.; 1808, c. 746, s. 2, P. R.; 1810, cc. 797, 802, P. R.; 1830, c. 33; 1838, c. 23; 1840, cc. 33, 34; 1852, c. 49; R. C., c. 59, s. 1; 1868-9, c. 162, ss. 27, 28; 1873-4, c. 90; 1874-5, c. 11; Code, ss. 2968, 2969; 1891, c. 195; Rev., s. 1916; C. S., s. 1633.)

**Insolvent's Application Is Proceeding in Cause in Which Convicted.**—The application of an insolvent confined for the non-payment of costs is a proceeding in the cause in which he was convicted, and should be made by petition to the court wherein the judgment against him was entered. *State v. Miller*, 97 N.C. 451, 1 S.E. 776 (1887).

**Prisoner May Appeal to Judge If Clerk Refuses to Give Oath.**—If the clerk should refuse to allow the prisoner to take the oath, the remedy is by an appeal to the judge holding the courts of that district. *State v. Miller*, 97 N.C. 451, 1 S.E. 776

(1887), intimating that release of prisoner on writ of habeas corpus by judge of adjoining district is irregular.

**Twenty-Day Provision Is Mandatory.**—Whether a defendant has property or not, he must remain in jail the twenty days, or pay the fine and costs, since the officers could not waive the imprisonment, nor had the judge the power to dispense with it. *State v. Davis*, 82 N.C. 610 (1880).

Neither the judge nor solicitor has the right to allow a defendant to take the insolvent's oath and obtain his discharge without remaining in prison for twenty days. *State v. Bryan*, 83 N.C. 611 (1880).

§ 23-26. **Warrant issued for prisoner.**—The clerk of the superior court, or justice of the peace, before whom such petition is presented shall forthwith issue a warrant to the sheriff, or keeper of the prison, requiring him to bring the prisoner before the court, at the time and place named for the hearing of the case, which warrant every such sheriff or keeper shall obey. (1773, c. 100, s. 1, P. R.; 1808, c. 746, s. 2, P. R.; 1810, cc. 797, 802, P. R.; 1830, c. 33; 1838, c. 23; 1840, cc. 33, 34; 1852, c. 49; R. C., c. 59, s. 1; 1868-9, c. 162, s. 29; Code, s. 2970; Rev., s. 1917; C. S., s. 1634.)

§ 23-27. **Proceeding on application.**—At the hearing of the petition, if the prisoner has no visible estate, and takes and subscribes the oath or affirmation prescribed in this article, the clerk of the superior court, or justice of the peace, before whom he is brought, shall administer the oath or affirmation to him, and discharge him from imprisonment, of which an entry shall be made in the docket of the court, and, where the proceeding is before a justice of the peace, the justice shall return the petition and orders thereon into the office of the clerk of the superior court to be filed. (1773, c. 100, s. 1, P. R.; 1808, c. 746, s. 2, P. R.; 1810, cc. 797, 802, P. R.; 1830, c. 33; 1838, c. 23; 1840, cc. 33, 34; 1852, c. 49; R. C., c. 59, s. 1; 1868-9, c. 162, s. 30; Code, s. 2971; Rev., s. 1918; C. S., s. 1635.)

**Cross Reference.**—See note to § 23-24.

§ 23-28. **Suggestion of fraud.**—The chairman of the board of commissioners, and every officer interested in the fee bill taxed against such prisoner, may oppose his taking the insolvent debtor's oath above prescribed, and file particulars of the suggestion in writing, in the court where the same shall stand for trial as prescribed in this chapter in other cases of fraud or concealment. (1868-9, c. 162, s. 32; Code, s. 2973; Rev., s. 1919; C. S., s. 1636.)

§ 23-29. **Persons taken in arrest and bail proceedings, or in execution.**—The following persons also are entitled to the benefit of this article as hereinafter provided:

- (1) Every person taken or charged on any order of arrest for default or [of] bail, or on surrender of bail in any action.
- (2) Every person taken or charged in execution of arrest for any debt or damages rendered in any action whatever. (1868-9, c. 162, s. 10; Code, s. 2951; Rev., s. 1920; C. S., s. 1637.)



**Cross Reference.**—As to arrest and bail, see §§ 1-409 to 1-439.

**Editor's Note.**—The word "of" in brackets in subdivision (1) is suggested as a correction of "or."

**Construed with §§ 1-417 and 1-419.**—This section should be construed with §§ 1-417 and 1-419, and, so construed, the remedies given by this section are in addition to those given by the other sections mentioned. *Edwards v. Sorrell*, 150 N.C. 712, 64 S.E. 898 (1909).

**Persons within Scope of Section.**—The terms of this section are as broad and sweeping as they well can be. They do not, in any view of them as to the purpose intended, imply limitation or discrimination. They plainly embrace "every person" taken or charged to be arrested by virtue of "any order of arrest," not specially for a tort, or for fraud, or other particular cause of action as to which a person may be arrested, but for any cause of action, no matter what may be its nature, if the person is arrested in a case wherein he may lawfully be so arrested. They, in plain, strong terms, embrace any such arrest made or ordered to be made in any action whatever—that is, an action in which a person—a party—may be so arrested. *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891).

The provisions of this section are broad and strong, and plainly extend to and embrace every person who may be arrested by virtue of an order of arrest issued pursuant to the provisions of § 1-410, and also extend to and embrace every person who has been seized by virtue of an execution against his person by authority of the provisions of § 1-311. *Allred v. Graves*, 261 N.C. 31, 134 S.E.2d 186 (1964).

**§ 23-30. When petition may be filed.**—Every person taken or charged as in the preceding section [§ 23-29] specified may, at any time after his arrest or imprisonment, petition the court from which the process issued on which he is arrested or imprisoned, for his discharge therefrom, on his compliance with this chapter. (*R. C.*, c. 59, s. 3; 1868-9, c. 162, s. 11; *Code*, s. 2952; *Rev.*, s. 1921; *C. S.*, s. 1638.)

**Cross Reference.**—See note to § 23-23.

**Persons Included.** — This section in broadest terms embraces "every person taken or charged as in the preceding section specified." *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891).

**Cause of Action Immaterial.** — The debtor is entitled to be discharged upon

The benefits of this section extend as well to those arrested for torts as for debt, and the debt growing out of one is no more a debt and no more entitled to an extraordinary process for its collection than the other. *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891).

The provisions of this section extend to and embrace every person arrested or to be arrested in a civil action on account of any cause of action specified in § 1-410. *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891).

**Nonresidents Are Included.**—The benefits of the section are not confined to residents of this State. There is no provision in it, or any other statute, within our knowledge, that in terms or by reasonable implication declares that a nonresident shall not be discharged from arrest in a civil action, if he makes the complete surrender of his estate as prescribed. *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891).

**Discharge May Be Sought After Motion to Vacate Arrest Denied.**—Where a party is under arrest in a civil action and his motion to vacate the arrest has been denied, he may seek his discharge under the provisions of this section. *Wing v. Hooper*, 98 N.C. 482, 4 S.E. 463 (1887).

**But Exempt Property over \$50 Must Be Surrendered.** — A judgment debtor against whose person execution has been issued cannot be discharged except by payment, or giving notice and surrender of all property in excess of \$50, and the effect of the execution against the person is to deprive him of his homestead and his personal property exemption over and above \$50. *Oakley v. Lasater*, 172 N.C. 96, 89 S.E. 1063 (1916).

the honest surrender of his property in the way prescribed, whether the cause of action on account of which he was arrested was a fraudulent debt, or a tort, or of other nature as to which he might be arrested. *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891).

**§ 23-31. Petition; contents; verification.**—The petition shall set forth the cause of the imprisonment, with the writ or process and complaint on which the same is founded, and shall have annexed to it a just and true account of all his estate, real and personal, and of all charges affecting such estate, as they exist

at the time of filing his petition, together with all deeds, securities, books or writings whatever relating to the estate and the charges thereon; and also what property, real and personal, the petitioner claims as exempt from sale under execution, and shall have annexed to it on oath or affirmation, subscribed by the petitioner and taken before any person authorized by law to administer oaths, to the effect following:

I, ....., the within named petitioner, do swear (or affirm) that the within petition and account of my estate, and of the charges thereon, are, in all respects, just and true; and that I have not at any time or in any manner disposed of or made over any part of my property, with a view to the future benefit of myself or my family, or with an intent to injure or defraud any of my creditors: so help me, God. (R. C., c. 59, s. 3; 1868-9, c. 162, ss. 12, 13; Code, ss. 2953, 2954; Rev., s. 1922; C. S., s. 1639.)

**§ 23-32. Notice; length of notice and to whom given.**—Twenty days notice of the time and place at which the petition will be filed, together with a copy of such petition and the account annexed thereto, shall be personally served by such debtor on the creditor or creditors at whose suit he is arrested or imprisoned, and such other creditors as the debtor may choose, or their personal representatives or attorneys. If the person to be notified reside out of the State, and has no agent or attorney in the State, the notice may be served on the officer having the claim to collect, or by two weekly publications in any newspaper in the State. (1773, c. 100, s. 8, P. R.; R. C., c. 59, ss. 3, 20; 1868-9, c. 162, s. 14; Code, s. 2955; Rev., s. 1923; C. S., s. 1640.)

**Only Creditors Notified Are Affected.**—The party arrested and seeking relief must notify the creditors or plaintiff at whose suit he is arrested, but he may or may not notify other creditors of his application to

surrender his property and be discharged from arrest, and only such creditors as may be so notified will be affected by his discharge. *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891).

**§ 23-33. Who may suggest fraud.**—Every creditor upon whom the notice directed in § 23-32 is served may suggest fraud upon the hearing of the petition, and the issues made up respecting the fraud shall stand for trial as in other cases. (1822, c. 1131, s. 4, P. R.; 1835, c. 12; R. C., c. 59, s. 13; 1868-9, c. 162, s. 15; Code, s. 2956; Rev., s. 1924; C. S., s. 1641.)

**Petitioner May Demand Oath and Jury Trial.**—A petitioner is entitled to insist that suggestions of fraud, made by a creditor, shall be verified by the oath of the creditor and tried by a jury; and it is error

in a judge to decide upon such suggestions, without submitting them in an issue to a jury. *Purvis v. Robinson & Co.*, 49 N.C. 96 (1856). See also *State v. Carroll*, 51 N.C. 458 (1859).

**§ 23-34. Where no suggestion of fraud, discharge granted.** — If no creditor suggests fraud or opposes the discharge of the debtor, the justice of the peace or the clerk of the superior court before whom the petition is heard shall forthwith discharge the debtor, and, if he surrenders any estate for the benefit of his creditors, shall appoint a trustee of such estate. The order of discharge and appointment shall be entered in the docket of the court, and if granted by a justice of the peace a copy thereof shall be certified by him to the clerk of the superior court, where the same shall be recorded, and filed. (1773, c. 100, P. R.; 1808, c. 746, s. 2, P. R.; 1810, c. 797, c. 802, P. R.; 1830, c. 33; 1838, c. 23; 1840, cc. 33, 34; 1852, c. 49; R. C., c. 59, s. 1; 1868-9, c. 162, s. 16; Code, s. 2957; Rev., s. 1925; C. S., s. 1642.)

**Discharge Held Improper.** — Where a debtor arrested and imprisoned for fraud did not tender the oath required by § 23-23, nor surrender his homestead and personal property exemptions, nor file the petition, nor give the notice required by

§ 23-32, he was improperly discharged upon an affidavit that he had theretofore made an assignment of all his property for the benefit of creditors and that he was at the date of the affidavit insolvent and not worth more than the exemptions

allowed him by law as set apart to him. *Raisin Fertilizer Co. v. Grubbs*, 114 N.C. 470, 19 S.E. 597 (1894).

**Proper Remedy to Secure Tort Damages.**

—The proper remedy of the party seeking to establish and secure his damages for

tort is to have a trustee appointed, under this section, to hold and distribute among creditors when and as soon as all debts are ascertained. *Burgwyn v. Hall*, 108 N.C. 489, 13 S.E. 222 (1891).

§ 23-35. **Continuance granted for cause.**—When it appears to the court that any debtor, who may have given bond for his appearance under this chapter, is prevented from attending court by sickness or other sufficient cause, the case shall be continued to another day, or to the next term, when the same proceedings shall be had as if the debtor had appeared according to the condition of his bond, and in the event of his death in the meantime, his bond shall be discharged. (1822, c. 1131, s. 1, P. R.; R. C., c. 59, s. 10; 1868-9, c. 162, s. 18; Code, s. 2959; Rev., s. 1926; C. S., s. 1643.)

**Cross Reference.**—As to the insolvent's bond, see § 23-40 and note thereto.

The extreme sickness of the principal would excuse his nonappearance, and entitle him and his surety to a continuance if that appeared to the court. But where it was not made to appear, the court could

not properly continue it. *Buis v. Arnold*, 53 N.C. 233 (1860).

**But Not Sickness of Surety.** — Under this section the sickness of the surety is no excuse for the default of the principal. *Speight v. Wooten*, 14 N.C. 327 (1832).

§ 23-36. **Where fraud in issue, discharge only after trial.**—After an issue of fraud or concealment is made up, the debtor shall not discharge himself as to the creditors in that issue, except by trial and verdict in the same, or by a discharge by consent. (R. C., c. 59, s. 17; 1868-9, c. 162, s. 21; Code, s. 2962; Rev., s. 1927; C. S., s. 1644.)

This section only applies to cases where the defendant is in lawful custody and by virtue of an authority competent to order

it. *Houston & Co. v. Walsh*, 79 N.C. 35 (1878).

§ 23-37. **If fraud found, debtor imprisoned.**—If, on the trial, the jury finds that there is any fraud or concealment, the judgment shall be that the debtor be imprisoned until a full and fair disclosure and account of all his money, property or effects be made by the debtor. (1822, c. 1131, s. 4, P. R.; 1835, c. 12; R. C., c. 59, s. 14; 1868-9, c. 162, s. 20; Code, s. 2961; Rev., s. 1928; C. S., s. 1645.)

**Must Surrender Property Fraudulently Conveyed.**—An insolvent debtor included in his schedule "all his interest in certain property assigned to S.C." On an issue found, the jury found the deed assigning such property fraudulent. It was held that the debtor should be imprisoned until he should make a surrender of the whole of such property. *Hutton v. Self*, 28 N.C. 285 (1846).

**Not in Execution as to Other Creditor.**

—A debtor convicted of fraudulent concealment of his effects, upon an issue between him and A, and ordered into custody thereupon, according to this section, is not in execution at the suit of B, another creditor, in whose case no such concealment was found or suggested. *Folsom v. Gregory*, 12 N.C. 233 (1827).

§ 23-38. **Effect of order of discharge.**—The order of discharge under the last four articles of this chapter, whether granted upon a nonsuggestion of fraud, upon the finding of a jury in favor of the debtor, or otherwise, shall be in like terms and have like effect as prescribed in § 23-16; except that the body of such debtor shall be free from arrest or imprisonment at the suit of every creditor, and as to him only, to whom the notice required may have been given; and the notices, or copies thereof, shall in all cases be filed in the office of the superior court clerk. (1822, c. 1131, s. 4, P. R.; 1835, c. 12; R. C., c. 59, s. 11; 1868-9, c. 162, s. 19; Code, s. 2960; Rev., s. 1929; C. S., s. 1646.)

**Debt Is Not Discharged.**—The discharge of the principal, under the insolvent

debtor's law, is not a discharge of the debt. *Norment v. Alexander*, 32 N.C. 71 (1849).



**Protects against Those Notified.**—The discharge of an insolvent protects him from arrest by those creditors only who had notice of his intention to apply for a dis-

charge. *Crain v. Long*, 14 N.C. 371 (1832); *Norment v. Alexander*, 32 N.C. 71 (1849); *Rountree v. Waddill*, 52 N.C. 309 (1859). See note to § 23-32.

## ARTICLE 5.

### *General Provisions under Articles 2, 3, and 4.*

**§ 23-39. Superior court tries issue of fraud.**—In every case where an issue of fraud is made up as provided in this chapter, the case shall be entered in the trial docket of the superior court, and stand for trial as other causes; and upon a finding by the jury in favor of the petitioner the judge shall discharge the debtor; if the finding is against the petitioner he shall be committed to jail until he makes full disclosure. (1868-9, c. 162, s. 8; Code, s. 2949; Rev., s. 1935; C. S., s. 1647.)

**Upon the suggestion of fraud an issue is raised** which should be entered upon the trial docket of the superior court and stand for trial as other causes. *State v. Parsons*, 115 N.C. 730, 20 S.E. 511 (1894).

**Issue Can Be Made Up When Schedule Shows Deed of Trust.**—When one who applies to take the insolvent debtor's oath, upon rendering a schedule, sets forth in his schedule that he has made a deed in trust of certain property to satisfy certain creditors, and surrenders all his interests in the property mentioned in such deed, it is still competent for the opposing creditor to have an issue made up whether

the said deed is not fraudulent, and if found fraudulent by a jury, to cause the debtor to be imprisoned until he surrenders the property itself. *Adams v. Alexander*, 23 N.C. 501 (1841).

**When Jury Finds Deed Fraudulent, Debtor Is Imprisoned Until Property Surrendered.**—Where an insolvent debtor, in filing his schedule, only surrenders his interest in certain property, conveyed by a deed in trust, and the jury, upon an issue, find the deed fraudulent, he must be imprisoned until he makes a surrender of the whole property so conveyed. *Hutton v. Self*, 28 N.C. 285 (1846).

**§ 23-40. Insolvent released on giving bond.**—Every debtor entitled under the provisions of this chapter to discharge as an insolvent may, at the time of filing his application for a discharge or at any time afterwards, tender to the sheriff or other officer having his body in charge, a bond, with sufficient surety, in double the amount of the sum due any creditor or creditors at whose suit he was taken or charged, conditioned for the appearance of such debtor before the court where his petition is filed, at the hearing thereof, and to stand to and abide by the final order or decree of the court in the case. If such bond be satisfactory to the sheriff, he shall forthwith release such debtor from custody. (R. C., c. 59, s. 27; 1868-9, c. 162, s. 17; Code, s. 2958; Rev., s. 1936; C. S., s. 1648.)

**Cross Reference.**—As to surety company being sufficient surety, see § 109-17.

**When Bond May Be Given.**—The insolvent may give bond during the pendency of and until the final determination of the proceedings. *Howie v. Spittle*, 156 N.C. 180, 72 S.E. 207 (1911).

**Sufficient Condition.**—A condition "to appear and claim the benefit of the act, etc., and not depart without leave," is substantially the same as that prescribed by this section. *Mooring v. James*, 13 N.C. 254 (1829).

**Who Prepares Bond.**—Whether it is the duty of the officer or the defendant to prepare the bond to be given for the defendant's appearance, *quaere*. *Winslow v. Anderson*, 20 N.C. 2 (1838).

**Day for Appearance Must Be Certain.**—The bond for the defendant's appearance, under this section, is in the nature of process to compel an appearance, and the day stated in the condition for appearance must be certain. *Winslow v. Anderson*, 20 N.C. 1 (1838).

**Where Date in Bond Erroneous.**—Where a bond was conditioned for the defendant's appearance at the next term of court to be held upon a stated day, and, at the next term which sat at a date earlier than that mentioned in the bond, the defendant did not appear, it was error to take a judgment against him and his surety for default since there was no default of appearance according to the bond. *Winslow v. Anderson*, 20 N.C. 1 (1838).



**Amount of Bond.**—A bond given under this section for the appearance of an insolvent to court, is good if it is for double the original debt, exclusive of interest and costs, and judgment, on motion, may be rendered on it. *Williams v. Yarbrough*, 13 N.C. 12 (1828).

**Defendant Cannot Object to Bond.**—A defendant who has given bond under this section cannot object to the informality of the bond, and pray a discharge on account thereof. *Page v. Winningham*, 18 N.C. 113 (1834).

**Nor to Ca. Sa. While Released on Bond.**—Where a defendant gave bond under the insolvent act, and while he is at large by virtue thereof, he is not entitled to his discharge on account of the fact that the ca. sa. is voidable; nor can he move, under

such circumstances, to quash the proceedings on that account. *Bryan v. Brooks*, 51 N.C. 580 (1859).

**Defendant Bound to Attend Every Term.**—The defendant in a ca. sa. bond, given under this section is bound to attend at every term until the cause is finally disposed of. *Arrington v. Bass*, 14 N.C. 95 (1831).

**Condition Is Broken by Default after Continuance.**—Where the defendant in the ca. sa. appeared at the return day of the writ, and upon an issue being made up, the cause was continued, and afterwards the defendant made a default, it was held that the condition of the bond was broken and the plaintiff entitled to judgment. *Mooring v. James*, 13 N.C. 254 (1829).

§ 23-41. **Surety in bond may surrender principal.**—The surety in any bond conditioned for the appearance of any person under this chapter may surrender the principal, or such principal may surrender himself, in discharge of the bond, to the sheriff or other officer of any court where such principal is bound to appear, in the manner provided in the chapter entitled Civil Procedure, article Arrest and Bail. (1793, c. 100, s. 7, P. R.; c. 380, s. 1, P. R.; 1822, c. 1131, s. 3, P. R.; R. C., c. 59, s. 23; 1868-9, c. 162, s. 22; Code, s. 2963; Rev., s. 1937; C. S., s. 1649.)

**Cross References.**—As to exoneration of bail in arrest and bail, see § 1-433. As to surrender of defendant by bail, see § 1-434. As to arrest of defendant by bail, see § 1-435.

**Right of Person Surrendered.**—A person who is surrendered in discharge of his bail is entitled to the benefit of this chapter for the relief of insolvent debtors. *Smallwood v. Wood*, 19 N.C. 356 (1837).

**Where Surrender to Be Made.**—Sureties to a ca. sa. bond, to protect themselves by a surrender of their principal, must make it in the court to which the ca. sa. is returnable, or to the sheriff of that county; where the writ issues to another county, a surrender to the sheriff of it is a nullity. *Mooring v. James*, 13 N.C. 254 (1829).

**Invalid Surrender.**—Where a prisoner was brought into open court by his bail, and it was announced, publicly, that he

was surrendered, but was unknown to the sheriff, to the plaintiff, and to the plaintiff's counsel, and he was a stranger to all present, except to the bail and the presiding judge, and upon being ordered in custody, he fled from the courtroom and escaped, without having been in the custody of the sheriff, it was held that these facts did not amount to a valid surrender. *Rountree v. Waddill*, 52 N.C. 309 (1859).

**Surrender Cannot Be Made after Judgment against Surety.**—When the principal obligor in a bond is regularly called at court, and, failing to appear, judgment is rendered against him and his surety, the surety has no right *ex debito justitiae* to come in on a subsequent day of the term and have the judgment set aside, in order to allow him to make a surrender of his principal. *Reynolds v. Boyd*, 23 N.C. 106 (1840).

§ 23-42. **Creditor liable for jail fees.**—When any debtor is actually confined within the walls of a prison, on an order of arrest in default of bail or otherwise, the jailer must furnish him with necessary food during his confinement, if the prisoner requires it, for which the jailer shall have the same fees as for keeping other prisoners. If the debtor is unable to discharge such fees, the jailer may recover them from the party at whose instance the debtor was confined. And at any time after the arrest, the sheriff or jailer may give notice thereof to the plaintiff, his agent or attorney, and demand security of him for the prison fees that accrue after such notice, and if the plaintiff fails to give such security then the sheriff may discharge the debtor out of custody. (1773, c. 100, ss. 8, 9, P.

R.; 1821, c. 1103, P. R.; R. C., c. 69, s. 5; 1868-9, c. 162, s. 24; Code, s. 2965; Rev., s. 1938; C. S., s. 1650.)

**Common-Law Provision.**—By the common law an imprisoned debtor was obliged to support himself, and, if unable to do so, was dependent upon the humanity of the jailer or of others. *Veal v. Flake*, 32 N.C. 417 (1849).

**Effect of Section.**—Where a man had been arrested and the issue had been continued from term to term, and his sureties had from time to time surrendered him and the issue had been decided against him and he had been committed to prison in all these cases, at the instance of the creditor, it was held, that under this section the creditor was responsible to the jailer for his fees or allowance for the food furnished to the prisoner during the whole time he was

confined in jail. *Veal v. Flake*, 32 N.C. 417 (1849).

**Where Prison Bounds Allowed.**—When a debtor is committed to prison, and is permitted to take the prison bounds, the jailer is not under any obligation, while he continues in the bounds, to furnish him provisions for his support, nor, of course, can the creditor, at whose suit he is confined, be compelled to reimburse the jailer for any sum so expended. *Phillips v. Allen*, 35 N.C. 10 (1851).

**Sheriff Cannot Bring Action.**—The action against the creditor for the jail fees of an insolvent debtor, given by this section to the jailer, cannot be maintained by the sheriff as the jailer's principal. *Bunting v. McIlhenny*, 61 N.C. 579 (1868).

§ 23-43. **False swearing; penalty.** — If any insolvent or imprisoned debtor takes any oath prescribed in this chapter falsely and corruptly, and upon indictment for perjury is convicted thereof, he shall suffer all the pains of perjury, and he shall never after have any of the benefits of this chapter, but may be sued and imprisoned as though he had never been discharged. (1793, c. 100, s. 10, P. R.; R. C., c. 59, s. 25; 1868-9, c. 162, s. 23; Code, s. 2964; Rev., ss. 1940, 3614; C. S., s. 1651.)

**Cross Reference.**—As to punishment for perjury, see § 14-209.

§ 23-44. **Powers of trustees hereunder.**—Any trustee appointed under the last four articles of this chapter, as therein contemplated, is hereby declared a trustee of the estate of the debtor, in respect to whose property such trustee is appointed for the benefit of creditors, and is invested from the time of appointment with all the powers and authority, and subject to the control, obligations and responsibilities prescribed by law in relation to personal representatives over the estates of deceased persons; but all debts shall be paid by the trustees pro rata. (1773, c. 100, ss. 5, 6, P. R.; 1827, c. 44; 1830, c. 26, s. 2; R. C., c. 59, ss. 21, 22; 1868-9, c. 162, s. 44; Code, s. 2977; Rev., s. 1941; C. S., s. 1652.)

§ 23-45. **Jail bounds.**—Any imprisoned debtor may take the benefit of the prison bounds by giving security, as required by law, except as follows:

- (1) A debtor against whom an issue of fraud is found.
- (2) Any debtor who, for other cause, is adjudged to be imprisoned until he makes a full and fair disclosure or account of his property. (1818, c. 964, P. R.; R. C., c. 59, s. 27; 1868-9, c. 162, s. 25; Code, s. 2966; Rev., s. 1942; C. S., s. 1653.)

**Cross Reference.**—As to liability for jail fees of debtor allowed prison bounds, see note to § 23-42.

## ARTICLE 6.

### *Practice in Insolvency and Certain Other Proceedings.*

§ 23-46. **Unlawful to solicit claims of creditors in proceedings.**—It shall be unlawful for any individual, corporation, or firm or other association of persons, to solicit of any creditor any claim of such creditor in order that such individual, corporation, firm or association may represent such creditor or present or vote such claim, in any bankruptcy or insolvency proceeding, or in any action

or proceeding for or growing out of the appointment of a receiver, or in any matter involving an assignment for the benefit of creditors. (1931, c. 208, s. 1.)

**Cross Reference.**—As to restrictions on appearance for creditor in insolvency proceedings, etc., see § 84-9. **Editor's Note.**—See 9 N.C.L. Rev. 348.

§ 23-47. **Violation of preceding section a misdemeanor.**—Any individual, corporation, or firm or other association of persons violating any provision of § 23-46 shall be guilty of a misdemeanor. (1931, c. 208, s. 3.)

#### ARTICLE 7.

*Bankruptcy of Taxing, etc., Districts, Counties, Cities, Towns and Villages.*

§ 23-48. **Local units authorized to avail themselves of provisions of bankruptcy law.**—With the approval of the Local Government Commission of North Carolina and with the consent of the holders of such percentage or percentages of its indebtedness as may be required by Public Act Number three hundred two of the Seventy-fifth Congress, First Session, entitled "An Act to amend an Act entitled 'An Act to establish a uniform system of bankruptcy throughout the United States' approved July first, one thousand eight hundred ninety-eight and Acts amendatory thereof and supplementary thereto," approved August sixteenth, one thousand nine hundred thirty-seven, as amended, any taxing district, local improvement district, school district, county, city, town or village in the State of North Carolina is authorized to avail itself of the provisions of said act of Congress as said act now exists or may be hereafter amended. (1939, c. 203.)

**Editor's Note.**—For comment on this section, see 17 N.C.L. Rev. 343.



## Chapter 24.

### Interest.

Sec.

24-1. Legal rate is six per cent.

24-2. Penalty for usury; corporate bonds may be sold below par.

24-3. Time from which interest runs.

24-4. Obligations due guardians to bear compound interest; rate of interest.

24-5. Contracts, except penal bonds, and judgments to bear interest; jury to distinguish principal.

24-6. Clerk to ascertain interest upon de-

Sec.

fault judgment on bond, covenant, bill, note or signed account.

24-7. Interest from verdict to judgment added as costs.

24-8. Loans of thirty thousand dollars or more to corporations.

24-9. Certain loans to corporations organized for profit not subject to claim or defense of usury.

**§ 24-1. Legal rate is six per cent.**—The legal rate of interest shall be six per cent per annum for such time as interest may accrue, and no more. (1876-7, c. 91; Code, s. 3835; 1895, c. 69; Rev., s. 1950; C. S., s. 2305.)

**Cross Reference.**—As to effect of secured transaction provisions of Uniform Commercial Code, see § 25-9-201.

**Editor's Note.**—The distinction between the "legal rate" of interest, and the "lawful rate" of interest, which is maintained in some states, and which appears in some of the older cases of this State, has not been preserved. Legal rate of interest implied the maximum rate at which interest could be charged upon an obligation in the absence of stipulation as to the rate; and a lawful rate of interest implied that rate of interest which could be lawfully stipulated without incurring the penalty of law. The former was six per cent, the latter eight. See *Burwell v. Burgwyn*, 100 N.C. 389, 6 S.E. 409 (1888). This distinction is now abolished, as the maximum rate at which interest may be charged, with or without stipulation of the rate, cannot exceed six per centum per annum under the provisions of this section and § 24-2.

**This section declares the policy of this State with regard to usury.** *Pinnix v. Maryland Cas. Co.*, 214 N.C. 760, 200 S.E. 874 (1939).

**Definition of "Interest."** — "Interest" is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, as damages for its detention. *Brown v. Hialts*, 82 U.S. (15 Wall.) 177, 21 L. Ed. 128 (1872).

**Regulating Interests within Province of Legislature.** — It is within the exclusive province of the lawmaking power to prescribe upon what conditions and at what

rate interest can be allowed or contracted for, and what shall be a forfeiture of the right to collect it. *Moore v. Beaman*, 112 N.C. 558, 17 S.E. 676 (1893).

**When Contract Is Usurious.**—A contract will be declared usurious when it appears that it was the purpose and intent of the lender to charge and receive a greater rate of interest than that allowed by law under this section. *Polikoff v. Finance Serv. Co.*, 205 N.C. 631, 172 S.E. 356 (1934).

**Insurance Companies Are Not Authorized to Charge Interest in Excess of Legal Rate.**—Section 58-32, dealing with loans by insurance companies secured by insurance policies, does not authorize insurance companies to charge interest in excess of the legal rate prescribed in this section. *Cowan v. Security Life & Trust Co.*, 211 N.C. 18, 188 S.E. 812 (1936).

**Premium for Privilege of Prepaying Notes.**—A provision in a deed of trust that the borrower should pay a premium, in addition to accrued interest at the legal rate, upon the exercise of its privilege of prepaying the notes before maturity, is valid. *Bell Bakeries, Inc. v. Jefferson Standard Life Ins. Co.*, 245 N.C. 408, 96 S.E.2d 408 (1957).

**Applied in** *Hackney v. Hood*, 203 N.C. 486, 166 S.E. 323 (1932); *White v. Disher*, 232 N.C. 260, 59 S.E.2d 798 (1950); *DeBruhl v. State Highway & Public Works Comm'n*, 247 N.C. 671, 102 S.E.2d 229 (1958); *H. F. Mitchell Constr. Co. v. Orange County Bd. of Educ.*, 262 N.C. 293, 136 S.E.2d 635 (1964).

**§ 24-2. Penalty for usury; corporate bonds may be sold below par.** —The taking, receiving, reserving or charging a greater rate of interest than six per centum per annum, either before or after the interest may accrue, when knowingly done, shall be a forfeiture of the entire interest which the note or other

evidence of debt carries with it, or which has been agreed to be paid thereon. And in case a greater rate of interest has been paid, the person or his legal representatives or corporation by whom it has been paid, may recover back twice the amount of interest paid in an action in the nature of action for debt. In any action brought in any court of competent jurisdiction to recover upon any such note or other evidence of debt, it is lawful for the party against whom the action is brought to plead as a counterclaim the penalty above provided for, to wit, twice the amount of interest paid as aforesaid, and also the forfeiture of the entire interest. If security has been given for an usurious loan and the debtor or other person having an interest in the security seeks relief against the enforcement of the security or seeks any other affirmative relief, the debtor or other person having an interest in the security shall not be required to pay or to offer to pay the principal plus legal interest as a condition to obtaining the relief sought but shall be entitled to the advantages provided in this section. Nothing contained in this section or in § 24-1, however, shall be held or construed to prohibit private corporations from paying a commission on or for the sale of their coupon bonds, nor from selling such bonds for less than the par value thereof; nor shall anything contained in this section or in §§ 24-1 and 24-3 be held or construed to prohibit private corporations from making contracts, incurring liabilities, borrowing money and paying a charge therefor not exceeding six per centum (6%) of the original amount of the loan for each twelve (12) months of the duration of the same, notwithstanding that such loan is payable in installments. (1876-7, c. 91; Code, s. 3836; 1895, c. 69; 1903, c. 154; Rev., s. 1951; C. S., s. 2306; 1955, c. 1196; 1959, c. 110.)

- I. General Consideration .
- II. Substance Controls Nature of Transaction.
  - A. General Doctrine.
  - B. Specific Instances.
- III. Equitable Doctrines as Affecting Rights of Parties.
- IV. Rights of Subsequent Purchasers.
- V. Usury Laws as Affecting Corporations.
- VI. Pleading and Practice.

#### Cross References.

As to limitation of actions to recover penalty and forfeiture of interest for usury, see § 1-53. As to party seeking to recover on any usurious contract not allowed costs, see § 6-25. As to usurious loans on household and kitchen furniture or assignments of wages made a misdemeanor, see § 14-391. As to Consumer Finance Act, see §§ 55-164 to 53-191. As to applicability of usury provisions to pawnbrokers, see § 91-7.

#### I. GENERAL CONSIDERATION.

**Editor's Note.**—See 12 N.C.L. Rev. 279 for note in reference to this section.

For brief comment on the 1955 amendment, see 33 N.C.L. Rev. 537 (1955).

**History.** — For history of this section, see *Commercial Credit Corp. v. Robeson Motors, Inc.*, 243 N.C. 326, 90 S.E.2d 886 (1956).

**Allowing Interest Is Matter of Legislative Discretion.**—At common law the taking of any interest was an indictable of-

fense; hence, interest is now purely statutory, being chargeable in such cases and to such extent only as is expressly allowed by statute. The entire subject of the rate of interest and penalties for usury rests in legislative discretion, and the courts have no power other than to interpret and execute the legislative will. *Smith v. Old Dominion Bldg. & Loan Ass'n*, 119 N.C. 249, 26 S.E. 41 (1896).

**Provisions Forbidding Usury and Declaring Forfeiture Are Clear.**—In *Moore v. Beaman*, 111 N.C. 328, 16 S.E. 177 (1892), it was said that the provisions of the law forbidding usury are very clear and explicit. No one can possibly misunderstand them. If moved by avarice a party deliberately violates this law, he has no ground to complain that his punishment has been in the very respect which caused him to sin, and that in grasping after illegitimate interest he has lost also the legitimate interest which the law would have given a law-abiding citizen.

**They will be strictly construed.** *Dixon v. Smith*, 204 N.C. 480, 168 S.E. 683 (1933).

**This section was copied from the National Bank Act**, and has gone into the laws of many states in exactly the same form. *Pinnix v. Maryland Cas. Co.*, 214 N.C. 760, 200 S.E. 874 (1939). See 12 U.S.C. § 86.

The North Carolina penalties for usury were identical with those prescribed in the National Bank Act. *Smith v. Old Dominion Bldg. & Loan Ass'n*, 119 N.C. 249, 26 S.E. 41 (1896).

**Purpose of Statute.**—Both the former and the present statutes were enacted in restraint of excessive interest for the same general policy, and especially on the idea of protecting the borrower against the oppression of the lender, the chief difference being that a violation under the old statute invalidated the contract, working a forfeiture of the sum lent as well as of the interest, whereas the present law leaves the contract valid for the principal, but makes the interest forfeitable. *Moore v. Woodward*, 83 N.C. 531 (1880).

Statutes prohibiting charging usury or an illegal rate of interest are enacted for the benefit of the borrower. *Ector v. Osborne*, 179 N.C. 667, 103 S.E. 388 (1920).

**Duty of Courts to Carry Out Legislative Intent.**—The forfeiture of the entire unpaid interest and recovery back of twice the interest paid is in the nature of a penalty intended to induce an observance of the statute, and it is the duty of the courts so to expound and apply the law as to carry out the legislative intent. *Moore v. Woodward*, 83 N.C. 531 (1880).

**Enforceability of Unlawful Interest in Absence of Penalty.**—Even in the absence of a penalty on charging usurious interest, such as contained in this section, a rate of interest above the one prescribed by law would not be enforceable. *Hughes v. Boones*, 102 N.C. 137, 9 S.E. 286 (1889).

**Effect of Usury Formerly and Now.**—By the former law, the taint of usury made the contract void both as to principal and interest into whose hands it might come, and so likewise any appearance, shift or device whereupon or whereby an illegal rate of interest was received or taken was declared to be void. By § 24-1 six per cent is fixed as the legal rate of interest, and in case more than the rate allowed is taken, received, reserved, or charged, the contract is not invalidated as to the principal, but the entire interest carried by the note or other evidence of debt, or otherwise agreed to be paid thereon, is, under this section, forfeited; and in case such greater rate has been paid, a remedy is given to the party paying the same to recover by action of debt twice the amount of the interest paid. *Moore v. Woodward*, 83 N.C. 531 (1880).

The forfeiture provided by this section will be enforced against the usurer, when he seeks to recover upon the usurious contract or transaction. His debt will be stripped of all its interest-bearing quality, and he will be permitted to recover only the principal sum loaned. If a sum in excess of interest at the legal rate has not only been charged by the lender, but has also been paid by the borrower for the use of money,

then the person, or his legal representative, or the corporation by whom the same has been paid, may recover twice the amount paid in an action in the nature of action for debt. *Waters v. Garriss*, 188 N.C. 305, 124 S.E. 334 (1924); *Sloan v. Piedmont Fire Ins. Co.*, 189 N.C. 690, 128 S.E. 2 (1925); *Ripple v. Mortgage & Acceptance Corp.*, 193 N.C. 422, 137 S.E. 156 (1927).

Under this section, usury does not invalidate a contract. It simply works a forfeiture of the entire interest, and subjects the lender to liability to the borrower for twice the amount of interest paid. *Wilkins v. Commercial Fin. Co.*, 237 N.C. 396, 75 S.E.2d 118 (1953).

A note otherwise valid is not rendered void either as to principal or interest by the taint of usury, but is subject only to the penalties and forfeitures of this section, one of which is the forfeiture of all interest when usury is properly pleaded and proven. *Pinnix v. Maryland Cas. Co.*, 214 N.C. 760, 200 S.E. 874 (1939), overruling in this respect, *Ward v. Sugg*, 113 N.C. 489, 18 S.E. 695, 24 L.R.A. 280 (1893); *Ripple v. Mortgage & Acceptance Corp.*, 193 N.C. 422, 137 S.E. 156 (1927), approving *Ector v. Osborne*, 179 N.C. 667, 103 S.E. 388, 13 A.L.R. 1207 (1920).

A note executed and delivered as evidence of the promise of the maker to pay to the payee or his order a sum of money which has been loaned by the payee to the maker, is not void, although the payee has, knowingly, taken, received, reserved, or charged interest on the note at a greater rate than six per cent per annum, which is the legal rate in this State; only the promise to pay interest is void in such case. *Federal Reserve Bank v. Jones*, 205 N.C. 648, 172 S.E. 185 (1934).

**Effect of Repeal of Old Law.**—A contract absolutely void under the old law for being usurious, is not validated by the repeal of that law and the enactment of this section which does not invalidate the principal of a usurious contract. *Pond v. Horne*, 65 N.C. 84 (1871).

**Four Requisites of Usurious Transaction.**—In order to constitute a usurious transaction, four requisites must appear: (1) There must be a loan, express or implied; (2) there must be an understanding between the parties that the money lent shall be returned; (3) that for such loan a greater rate of interest than is allowed by law shall be paid or agreed to be paid, as the case may be; and (4) there must exist a corrupt intent to take more than the legal rate for the use of the money loaned. A profit greater than the lawful rate of interest, intentionally exacted as a bonus for the loan



of money, imposed upon the necessities of the borrower in a transaction where the treaty is for a loan and the money is to be returned at all events, is a violation of the usury laws, it matters not what form or disguise it may assume. *Doster v. English*, 152 N.C. 339, 67 S.E. 754 (1910), approved in *Monk v. Goldstein*, 172 N.C. 516, 90 S.E. 519 (1916); *Loan & Trust Co. v. Yokley*, 174 N.C. 573, 94 S.E. 102 (1917); *Ector v. Osborne*, 179 N.C. 667, 103 S.E. 388 (1920); *Preyer v. Parker*, 257 N.C. 440, 125 S.E.2d 916 (1962); *Associated Stores, Inc. v. Industrial Loan & Inv. Co.*, 202 F. Supp. 251 (E.D.N.C. 1962).

To maintain an action for the usury penalty the claimant must show: (1) That there was a loan, express or implied, or a forbearance of money; (2) that there was an understanding between the parties that the money lent would be returned; (3) that for such loan or forbearance a greater rate of interest than is allowed by law was paid; and (4) that there was a corrupt intent to take more than the legal rate for the use of the money. *Carolina Industrial Bank v. Merrimon*, 260 N.C. 335, 132 S.E.2d 692 (1963).

**Forbearance of Debt or Loan of Money Is Essential.**—It is universally held that in order that a transaction shall fall within the prohibition of the statutes against usury it is essential that there should be a contract for the forbearance of an existing indebtedness or a loan of money. There is no exception to this universal rule, that there must be an extension of credit and an illegal compensation for it, knowingly taken, in order to constitute usury. This is recognized in the earliest cases on the subject up to the present time. *Smithwick v. Whitley*, 152 N.C. 366, 67 S.E. 914 (1910).

Usury can only attach to a loan of money or to forbearance of a debt. *Carolina Industrial Bank v. Merrimon*, 260 N.C. 335, 132 S.E.2d 692 (1963).

**As Is Corrupt Intent to Charge Usurious Interest.**—To constitute a usurious transaction, corrupt intent to take more than the legal rate of interest is an essential element. *Bailey v. Inman*, 224 N.C. 571, 31 S.E.2d 769 (1944).

The statutory penalty for charging usurious interest is imposed only when a corrupt intent exists to take more than the legal rate. *Perry v. Doub*, 249 N.C. 322, 106 S.E.2d 582 (1959).

**That Is, Intentional Charging of More Than Lawful Rate.**—The "corrupt intent" required to constitute usury is simply the intentional charging of more for money lent than the law allows. *Associated Stores,*

*Inc. v. Industrial Loan & Inv. Co.*, 202 F. Supp. 251 (E.D.N.C. 1962).

**Which in Itself Shows Corrupt Intent.**—Where the lender of money intentionally charges the borrower a greater rate of interest than the law allows, and his purpose stands clearly revealed on the face of the instrument, a corrupt intent to violate the usury law on the part of the lender is shown. *Riley v. Sears*, 154 N.C. 509, 70 S.E. 997 (1911).

**But Contract Must Have Been Executed in Bad Faith.**—To constitute an intent to circumvent the usury laws, the contract must have been executed in bad faith, such "bad faith" meaning that the transaction involved was dishonestly conceived and consummated with knowledge of a fraudulent design or deception. *Clarkson v. Finance Co. of America*, 328 F.2d 404 (4th Cir. 1964).

**Penalties for Charging and Collecting Usury.**—Where a usurious rate of interest on money has been paid by the borrower of money, the statutory penalty is double the amount of the usury, but where it is only charged, and not collected, the statute eliminates the usury and forfeits the interest on the amount of the loan. *Ragan v. Stephens*, 178 N.C. 101, 100 S.E. 196 (1919).

**Recovery Is of Double Entire Interest Paid.**—Under the clear terms of this section the plaintiff is entitled to recover back double the entire interest paid, not merely double the usurious excess. *Taylor v. Parker*, 137 N.C. 418, 49 S.E. 921 (1905).

**Even Where Plaintiff Is in Pari Delicto.**—A borrower who has paid usurious interest may, under this section recover of the lender twice the amount of usurious interest so paid, notwithstanding that he is in pari delicto in the transaction. *Hollowell v. Southern Bldg. & Loan Ass'n*, 120 N.C. 286, 26 S.E. 781 (1897).

**But Payment Is Necessary for Recovery.**—Before the plaintiff can maintain the action he must pay the usury in money or money's worth. It is well settled that the penalty is not incurred by the charging of usurious interest; it is by taking the usury that the party incurs the penalty, and no action lies therefor until it is paid. *Stedman v. Bland*, 26 N.C. 296 (1844); *Godfrey v. Leigh*, 28 N.C. 390 (1846); *Rushing v. Bivens*, 132 N.C. 273, 43 S.E. 798 (1903).

**And a renewal of the note does not constitute such payment of the original debt.** *Ragan v. Stephens*, 178 N.C. 101, 100 S.E. 196 (1919).

**Recovery Cannot Be Had on Allegation of Overpayment by Mistake.**—In an action to recover for overpayment of interest, made by mistake, recovery cannot be had

for the forfeiture of double the interest as a penalty for usury, since, upon the allegation of such overpayment by mistake, no legal implications arise that the plaintiff is suing for the forfeiture. *Gillam v. Life Ins. Co.*, 121 N.C. 369, 28 S.E. 470 (1897).

**Intentional Charging Forfeits Entire Interest.** — This section makes the "taking, receiving, reserving or charging usury," when knowingly done, i.e., intentionally done, and not by a mere error of calculation, a forfeiture (not merely forfeitable) of the entire interest which the note carries with it, or which has been agreed to be paid thereon. *Ward v. Sugg*, 113 N. C. 489, 18 S.E. 717 (1893).

All interest is forfeited when usury is knowingly exacted. *Guaranty Bond & Mortgage Co. v. Fair Promise A.M.E. Zion Church*, 219 N.C. 395, 14 S.E.2d 37 (1941).

**But Mere Entry Does Not Constitute Charging.**—The mere entry on account and subsequent presentation of a usurious claim is not a "charging" within the meaning of this section. *Grant v. Morris & Sons*, 81 N.C. 150 (1879).

**Junior Lienor Has Same Rights as Mortgagor as to Senior Debt.**—A junior mortgagee enjoining the sale under a senior lien is entitled to have the senior debt stripped of usury and the amount of the debt ascertained at the amount advanced plus interest thereon at the legal rate of six per cent, this being the relief to which the mortgagor would be entitled, and equity requiring that the same rule should be applicable to the junior lienor. *Pinnix v. Maryland Cas. Co.*, 214 N.C. 760, 200 S.E. 874 (1939).

**Creditor May Not Evade Statute by Assigning His Debt.**—Where defendants had a right to plead usurious payments as a setoff or defense to any action brought by the original creditor, the creditor could not evade the express language of this section by assigning his debt to a third person. *Overton v. Tarkington*, 249 N.C. 340, 106 S.E.2d 717 (1959).

**Insurance Companies Are Subject to Penalties.** — An insurance company which charges, retains, or receives interest on a loan made by it in this State, to a policyholder or other person, at a rate in excess of six per centum per annum, is subject to the penalties prescribed by this section notwithstanding the provisions of § 58-32 as to the premiums paid on policies. *Cowan v. Security Life & Trust Co.*, 211 N.C. 18, 188 S.E. 812 (1936).

Two remedies are provided for the enforcement of the penalties authorized by this section: First. Where a greater rate of interest than six per centum per annum

has been paid, the person or his legal representatives or the corporation by whom it has been paid, may recover back twice the amount of interest paid, in an action at law in the nature of an action for debt Second. In any action brought by the creditor to recover upon any usurious note or other evidence of debt affected with usury, it is lawful for the party against whom the action is brought to plead as a counterclaim or setoff, the penalties provided by the statute, to-wit, twice the amount of interest paid, and also the forfeiture of the entire interest charged. *Waters v. Garriss*, 188 N. C. 305, 124 S.E. 334 (1924); *Overton v. Tarkington*, 249 N.C. 340, 106 S.E.2d 717 (1959).

**The borrower may waive his rights under this section.** *Ector v. Osborne*, 179 N.C. 667, 103 S.E. 388 (1920).

By consent judgment entered in an action upon a note, wherein usury was set up by the defendant, and the parties have agreed upon a compromise in a certain sum, signed and entered by the court, the defendant waives his right under the usury law, and may not thereafter maintain the defense that a note he had given the plaintiff, in the amount of the judgment, was tainted with the usury of the first transaction. *Ector v. Osborne*, 179 N.C. 667, 103 S.E. 388 (1920).

**New Note Must Be in the Nature of a Compromise in Order to Constitute a Waiver of Right to Plead Usury.**—A usurious contract is not purged of the usury by the execution of renewals or by a change in the form of the contract, or by the giving of a separate note for the usurious charge, and in order for an agreement as to the total debt and the execution of a new note therefor to constitute a waiver of the right to plead usury, the new amount arrived at must be agreed to by the debtor as just and due the creditor, taking into consideration his claim of usury, and be in the nature of a compromise and settlement and be a novation rather than a renewal. *Hill v. Lindsay*, 210 N.C. 694, 188 S.E. 406 (1936).

Thus, where it was found that the parties agreed upon the total amount of the debt after an accounting involving the credit of sums obtained from the sale of collateral given for the debt, but not involving the question of usury, and that the debtor executed a new note for the balance thus arrived at, it was held insufficient to support the court's conclusion of law that the debtor waived the right to claim usury, the transaction being a renewal rather than a novation. *Hill v. Lindsay*, 210 N.C. 694, 188 S.E. 406 (1936).



**Usurious Interest on Other Bonds Is Defense to Suit on Chattel Mortgage Securing Such Interest.**—In an action of claim and delivery for certain property conveyed by a chattel mortgage, the defendant can set up the defense of usury upon the allegation that the sole consideration of the bond secured by the mortgage was usurious interest, which had accrued upon certain other bonds executed by the defendant to the plaintiff. *Moore v. Woodward*, 83 N.C. 531 (1880).

**Applied** in *White v. Disher*, 232 N.C. 260, 59 S.E.2d 798 (1950); *Perry v. Doub*, 238 N.C. 233, 77 S.E.2d 711 (1953); *Auto Fin. Co. v. Simmons*, 247 N.C. 724, 102 S.E.2d 119 (1958); *Harrington v. Tucker*, 261 N.C. 372, 134 S.E.2d 625 (1964).

**Cited** in *Bundy v. Commercial Credit Co.*, 198 N.C. 339, 151 S.E. 626 (1930); *McNeill v. Suggs*, 199 N.C. 477, 154 S.E. 729 (1930); *Fletcher v. Parlier*, 206 N.C. 904, 173 S.E. 343 (1934); *Flythe v. Wilson*, 227 N.C. 230, 41 S.E.2d 751 (1947).

## II. SUBSTANCE CONTROLS NATURE OF TRANSACTION.

### A. General Doctrine.

**Form of Transaction Cannot Conceal Its Usurious Nature.**—An express or implied loan, upon the understanding that the money shall be returned at a greater interest rate than the statute allows, whatever the form of the transaction, and with corrupt intent on the part of the lender, is usury under this section, the corrupt intent consisting in "taking, receiving, reserving, or charging" a greater rate than that allowed by law. *Swamp Loan & Trust Co. v. Yokley*, 174 N.C. 573, 94 S.E. 102 (1917).

Where a transaction is in reality a loan of money, whatever may be its form, and the lender charges for the use of his money a sum in excess of interest at the legal rate, by whatever name the charge may be called, the transaction will be held to be usurious. The law considers the substance and not the mere form or outward appearance of the transaction in order to determine what it in reality is. If this were not so, the usury laws of the State would easily be evaded by lenders of money who would exact from borrowers with impunity compensation for money loaned in excess of interest at the legal rate. *Ripple v. Mortgage & Acceptance Corp.*, 193 N.C. 422, 137 S.E. 156 (1927).

The courts do not hesitate to look beneath the forms of transactions alleged to be usurious in order to determine whether or not such transactions are in truth and in reality usurious. In *Planters Nat'l Bank*

*v. Wysong & Miles Co.*, 177 N.C. 380, 99 S.E. 199 (1919), Justice Walker, speaking of a transaction alleged to be usurious, says: "This kind of usurious agreement has been cast in various forms, but the courts have invariably stripped it of its flimsy disguises, and decided according to its substance, and its tendency and effect, when the purpose and intent of the lender is unmistakable." *Ripple v. Mortgage & Acceptance Corp.*, 193 N.C. 422, 137 S.E. 156 (1927).

Where there is negotiation for a loan of money, and the borrower agrees to return the amount advanced at all events, it is a contract of lending; and however the transaction may be shaped or disguised, if a profit or return beyond the legal rate of interest is intended to be made out of the necessities or improvidence of the borrower, or otherwise, the contract is usurious. *MacRackan v. Bank of Columbus*, 164 N.C. 24, 80 S.E. 184 (1913); *Swamp Loan & Trust Co. v. Yokley*, 174 N.C. 573, 94 S.E. 102 (1917).

The nature and terms of the contract determine its character and purpose, and if usurious in itself it must be so understood to have been intended by the parties, and they cannot be heard to the contrary. So the parties to a contract usurious upon its face, understandingly entered into, must be deemed to have intended to provide for the payment of a rate of interest in excess of that allowed by law, and that is itself a usurious contract. *Burwell v. Burgwyn*, 100 N.C. 389, 6 S.E. 409 (1888).

In construing a transaction with regard to the usury statutes the court, will look to its substance and not to its form. *Pratt v. American Bond & Mortgage Co.*, 196 N.C. 294, 145 S.E. 396 (1928).

### B. Specific Instances.

**Requiring Bank Depositor-Borrower to Maintain Balance.**—Where a bank has followed an arrangement made by its depositor that the latter keep a certain per cent of the money borrowed upon his own paper and paper of its customers upon which he remains responsible, and which is good and collectible by the bank without trouble to it, and thus collects on the series of transactions a rate of interest in excess of the legal rate, the interest thus received is usurious and comes within the intent and meaning of the statute forbidding it. *English Lumber Co. v. Wachovia Bank & Trust Co.*, 179 N.C. 211, 102 S.E. 205 (1920).

**Where a building and loan association charges a stockholder certain fines under § 54-15**, such fines cannot be alleged as interest paid on the loan from the corpora-



tion. *Moore v. Mutual Bldg. & Loan Ass'n*, 203 N.C. 592, 166 S.E. 597 (1932).

**As to building and loan associations generally**, see § 54-22 and note thereto.

**Sum Deducted Must Be Reserved as Interest.**—Where a borrower executed notes for the principal sum borrowed and notes for the interest on the principal notes from the time of their execution until their respective maturities, and the lender paid the borrower the principal sum borrowed less an amount deducted and retained by the lender, in the absence of an agreed fact or a finding by the court that the sum deducted was reserved by the lender as interest, the transaction did not constitute usury, and therefore the notes were not tainted with usury in the hands of a purchaser. *Ray v. Atlantic Life Ins. Co.*, 207 N.C. 654, 178 S.E. 89 (1935).

**But Name of Charge Is Immaterial.**—Any charges made by a building and loan association against a borrowing member, in excess of the legal rate of interest, whether such charges are called "fines," "dues" or "interest," are usurious. *Hollowell v. Southern Bldg. & Loan Ass'n*, 120 N.C. 286, 26 S.E. 181 (1897).

**Stipulation That Laws of Another State Should Apply.**—Where the court finds that the stipulation in a contract that the laws of another state should apply was made in bad faith for the purpose of evading the usury laws of this State, and that defendant charged and received payment of usurious interest, the findings are sufficient to support a judgment in plaintiff's favor that he recover of defendant twice the amount of usurious interest paid as determined by this section. *Polikoff v. Finance Serv. Co.*, 205 N.C. 631, 172 S.E. 356 (1934).

The Maryland usury statute was controlling in determining whether a loan agreement between a North Carolina corporation and a Maryland finance corporation was usurious where the agreement was first executed in this State and then mailed to the Maryland office of the finance corporation for signing and where the agreement's direction that the entire transaction be measured upon the laws of Maryland was in no degree illegal, opposed to public policy, or offensive to the good morals of either state. *Clarkson v. Finance Co. of America*, 328 F.2d 404 (4th Cir. 1964).

**Usury in Fact Made Payable in This State.**—Where in fact a contract for the payment of usurious interest, in violation of § 24-1 et seq. was made payable in this State, the fact that it appeared from the face of the contract that it was payable in another state, does not relieve it of its usurious charge of interest contrary to the

statute of this State. *Ripple v. Mortgage & Acceptance Corp.*, 193 N.C. 422, 137 S.E. 156 (1927).

**Sum Paid to Trust Company Held to Be a Reasonable Brokerage Fee.**—Two thousand six hundred dollars paid to a trust company for its services in handling ninety \$1,000 bonds bearing interest at the legal rate was held not to constitute usury, but a reasonable brokerage fee. *McCubbins v. Virginia Trust Co.*, 80 F.2d 984 (4th Cir. 1936).

**A bona fide credit sale upon an installment payment basis does not involve a loan of money or a forbearance of a debt within the meaning and application of the usury laws.** *Carolina Industrial Bank v. Merrimon*, 260 N.C. 335, 132 S.E.2d 692 (1963).

If there is a real and bona fide purchase, not made as the occasion or pretext for a loan, the transaction will not be usurious even though the sale be for an exorbitant price, and a note is taken, at legal rates, for the unpaid purchase money. *Carolina Industrial Bank v. Merrimon*, 260 N.C. 335, 132 S.E.2d 692 (1963).

**Conditional Sale.**—An action to recover alleged usurious interest paid cannot be maintained upon evidence disclosing that the transaction alleged was not a loan but was a sale with deferred payment secured by conditional sale contract. *Hendrix v. Harry's Cadillac Co.*, 220 N.C. 84, 16 S.E.2d 456 (1941).

**Loan by Finance Corporation for Purchase of Automobiles.**—Where a finance corporation loans money for the purchase of automobiles sold in this State to be paid for at a greater rate of interest than six per cent, the transaction is a usurious one coming within the inhibition of the usury statute and the penalty it imposes, though the contract is couched in the language of bargain and sale in order to evade the usury law. *Ripple v. Mortgage & Acceptance Corp.*, 193 N.C. 422, 137 S.E. 156 (1927).

### III. EQUITABLE DOCTRINES AS AFFECTING RIGHTS OF PARTIES.

**Editor's Note.**—Prior to the 1959 amendment to this section, which inserted the present fourth sentence, it was held that in equity, while a usurious lender could have no relief whatever, neither could a borrower have relief against such a lender, such as enjoining the enforcement of a mortgage, without repaying the principal plus lawful interest. The basis of this principle was the equitable maxim, "he

who seeks equity must do equity." See *McBrayer v. Roberts*, 17 N.C. 75 (1831); *Cook v. Patterson*, 103 N.C. 127, 9 S.E. 402 (1889); *Miller v. Dunn*, 188 N.C. 397, 124 S.E. 746 (1924); *Waters v. Garriss*, 188 N.C. 305, 124 S.E. 334 (1924); *Jonas v. Home Mortgage Co.*, 205 N.C. 89, 170 S.E. 127 (1933); *North Carolina Mortgage Corp. v. Wilson*, 205 N.C. 493, 171 S.E. 783 (1933); *Pinnix v. Maryland Cas. Co.*, 214 N.C. 760, 200 S.E. 874 (1939). However, it was held that such principle did not apply to a proceeding by a debtor at law for the statutory penalty. See *Cheek v. Iron Belt Bldg. & Loan Ass'n*, 127 N.C. 121, 37 S.E. 150 (1900); *Cuthbertson v. Peoples Bank*, 170 N.C. 531, 87 S.E. 333 (1915). And there had been some criticism of cases applying the doctrine. See *Moore v. Beaman*, 112 N.C. 558, 17 S.E. 676 (1893); *Churchill v. Turnage*, 122 N.C. 426, 30 S.E. 122 (898) (dis. op.).

Where the payee withholds from the borrower a part of the face amount of the note, the same being a device to evade the usury laws, the borrower is entitled in equity to have the note credited with the amount so withheld upon the maturity of the note as against the payee under this section. *Federal Reserve Bank v. Jones*, 205 N.C. 648, 172 S.E. 185 (1934).

#### IV. RIGHTS OF SUBSEQUENT PURCHASERS.

**Holder in Due Course Occupies No Better Position than Lender.** — As to usurious contracts, the law regards the maker, not as in *pari delicto*, but as acting "in chains," and to permit his contract, which is deemed exacted under duress, to come under the general rule in favor of innocent holders for value of commercial paper, would be to nullify the protecting statute. The recourse of the holder is against the payee and indorser, who is more likely by far to be able to respond than the maker. *Ward v. Sugg*, 113 N.C. 489, 18 S.E. 717 (1893).

Prior to this section, a usurious contract worked a forfeiture of both the interest and the debt, and it was stated in *Coor v. Spicer*, 65 N.C. 401 (1871), that under the operation of such a statute, innocent and meritorious holders were obliged to suffer. *Faison v. Grandy & Sons*, 126 N.C. 827, 36 S.E. 276 (1900).

**A note tainted with usury retains the taint in the hands of a subsequent holder.** The forfeiture of interest is the decree of the law. *Faison v. Grandy & Sons*, 126 N.C. 827, 36 S.E. 276 (1900).

In *Glenn v. Farmer's Bank*, 70 N.C. 191

(1874), *Rodman, J.*, says: "It is admitted law that notes vitiated by an usurious or gaming consideration cannot be enforced in the most innocent hands, but are always and under all circumstances void." *Ward v. Sugg*, 113 N.C. 489, 18 S.E. 717 (1893).

**Contrary Rule Would Render Usury Statute Nugatory.**—If, by passing the note off before maturity and for value, the indorsee may recover on it, the statute is useless, as the protection intended and the penalty and prohibition are alike rendered nugatory. The victim would have no recourse but to suffer in silence. The usury would be collected in spite of the law which had declared the "entire interest forfeited" *ab initio*, by the fact of "charging or reserving" it. On the other hand, the innocent indorsee has his recourse against the payee who has indorsed the note to him, a recourse which would more surely protect him, being against the party who has money to loan, not to borrow. *Ward v. Sugg*, 113 N.C. 489, 18 S.E. 717 (1893).

**Rule Applies to Obligations Secured by Mortgages.**—The only case that seems to mitigate against the otherwise uniform tenor of the decisions on this subject is *Coor v. Spicer*, 65 N.C. 401 (1871), which holds that a mortgage given to secure a usurious bond might be enforced in the hands of an innocent purchaser for value. The case recognizes the general rule, but takes mortgages out of it upon the supposed wording of § 39-20. Aside from the fact that this is held expressly otherwise in the later case of *Moore v. Woodward*, 83 N.C. 531 (1880), an examination of § 39-20 will show that *Coor v. Spicer* was a palpable inadvertence. That statute in fact does not purport to protect the innocent holder of a mortgage note which is tainted with usury but the "purchaser of the estate or property" at sale under the mortgage, who buys without notice of the usurious taint in the debt secured. It would be a fraud for the mortgagor to stand by and let him purchase without giving him notice, but the maker can give no notice usually to the assignee of the note. *Ward v. Sugg*, 113 N.C. 489, 18 S.E. 717 (1893).

**"Shall Be a Forfeiture" Construed.** — The Supreme Court has expressly held that the words, "shall be a forfeiture," in this section makes void the agreement as to interest. *Ward v. Sugg*, 113 N.C. 489, 18 S.E. 717 (1893).

#### V. USURY LAWS AS AFFECTING CORPORATIONS.

**Corporations Are Embraced within Usury Laws.**—In the absence of special

legislation, corporations are embraced in the usury laws just as natural persons are. *Commissioners v. Atlantic & N.C.R.R.*, 77 N.C. 289 (1877).

**Conflict of Laws.**—A statute of another state forbidding corporations to plead usury as a defense, cannot govern a corporation of this State sued in this State, although the bonds in question were delivered in the other state and made payable there. *Commissioners v. Atlantic & N.C.R.R.*, 77 N.C. 289 (1877).

Where such bonds express a rate of interest illegal in this State, and also in the other state, and were issued in payment of a precedent debt and secured by a mortgage on the corporation's property, they could legally bear no greater rate of interest than that allowed in this State. *Commissioners v. Atlantic & N.C.R.R.*, 77 N.C. 289 (1877).

**Sale of Bonds at Discount.**—In *Commissioners v. Atlantic & N.C.R.R.*, 77 N.C. 289 (1877), it was held that a corporation could not legally sell its bonds, bearing the highest legal rate of interest, at a discount for the purpose of borrowing money. Such a sale was in effect a loan, and was usurious. But the doctrine of this case is abrogated by the last sentence of this section, which allows such a course.—Ed. Note.

**Provisions of Corporate Charter Construed.**—In *Simonton v. Lanier*, 71 N.C. 498 (1874), the plaintiff contended that the following language in his alleged act of incorporation, "May discount notes and other evidences of debt, and lend money upon such terms and rates of interest as may be agreed upon," conferred the right to exact a rate of interest greater than the legal rate. It was held that the statute nowhere confers an express power to exceed the legal rate of interest and that the operative words, "any rate of interest that may be agreed on," meant any rate of interest not greater than the legal rate.

**Building and Loan Associations.** — See § 54-22 and note thereto.

## VI. PLEADING AND PRACTICE.

**Usury must be pleaded.** *Dixon v. Smith*, 204 N.C. 480, 168 S.E. 683 (1933).

**And Proved.**—Where there is no evidence that any holder of the note executed by plaintiffs has charged or received interest thereon in excess of six per cent, in an action on the note plaintiffs may not invoke the forfeiture of interest for usury. *Smith v. Bryant*, 209 N.C. 213, 183 S.E. 276 (1936).

**By Whom May Be Pleased.**—The plea

of usury is open to the parties and their privies, and may be made when, by the transaction, the debtor's estate is wrongfully depleted, and ordinarily by one having the legal right to protect the estate, as a receiver of an insolvent corporation against which a usurious contract is sought to be enforced. *Riley v. Sears*, 154 N.C. 509, 70 S.E. 997 (1911).

**Same—Rights of Trustee in Bankruptcy.**—A right of action to recover the penalty for a usury charge is in the nature of an action for debt, and is a wrongful detention of, or injury to, the estate of the bankrupt which passes to his trustee in bankruptcy. *Ripple v. Mortgage & Acceptance Corp.*, 193 N.C. 422, 137 S.E. 156 (1927).

**As a Defense.**—Where the payee of a promissory note or bond brings action thereon and the defendant sets up a deduction on account of usury, within the plain intent and meaning of this section the plaintiff will not be entitled to recover the usurious charge. *Pugh v. Scarboro*, 200 N.C. 59, 156 S.E. 149 (1930).

A claim of forfeiture of all interest for usury may be properly set up as a defense in the creditor's action on the debt without a tender of the debt with legal interest, tender required only when the debtor seeks affirmative equitable relief such as enjoining the collection of the debt or the foreclosure of the security therefor. *Virginia Trust Co. v. Lambeth Realty Corp.*, 215 N.C. 526, 2 S.E.2d 544 (1939).

**When Counterclaim Available.** — While a counterclaim for usury may be set up in an action on a note under this section, such counterclaim may not be set up in an action in ejectment based on title to the property under foreclosure of the deed of trust securing the note. *North Carolina Mortgage Corp. v. Wilson*, 205 N.C. 493, 171 S.E. 783 (1933).

The purpose and intent of the counterclaim provision was not to restrict the right of recovery by way of counterclaim, but rather to make it clear that the right granted by the statute to recover the penalty for usurious interest paid "in the action in the nature of action for debt," could be pleaded as a counterclaim in an action between the parties. *Commercial Credit Corp. v. Robeson Motors, Inc.*, 243 N.C. 326, 90 S.E.2d 886 (1956).

While this section provides that a counterclaim for usury may be set up in an action to recover upon the note or other evidence of debt, on which the alleged usurious interest has been charged, such a counterclaim may not be pleaded in an action based on other cause of action. Com-



mercial Fin. Co. v. Holder, 235 N.C. 96, 68 S.E.2d 794 (1952).

There is no conflict between this section and subsection (2) of § 1-137 in reference to pleading of counterclaim for usury. Commercial Credit Corp. v. Robeson Motors, Inc., 243 N.C. 326, 90 S.E.2d 886 (1956).

Construing this section and § 1-137 (2) in *pari materia*, where a lender brings an action to recover on a note or other evidence of debt, the borrower, by counterclaim in such action, can recover the penalty for usurious interest paid by the borrower to the lender in connection with separate and independent transactions between them. Commercial Credit Corp. v. Robeson Motors, Inc., 243 N.C. 326, 90 S.E.2d 886 (1956).

**Definiteness of Allegations.**—In an action brought to recover money alleged to be due on a contract entered into between the parties, wherein the plea of usury is set up in the answer and a recovery is sought under this section for double the amount of the interest paid, the recovery sought is in the nature of a penalty; when the facts are known or readily obtainable the law requires a definite statement in the pleading as to the time and amount, before allegations in such action are held to be sufficient, and when such statement is not made no amendment to the pleadings should be allowed. *Riley v. Sears*, 154 N.C. 509, 70 S.E. 997 (1911).

**Statute of Limitations.**—An action to recover the penalty for usury, under this section, is barred after the lapse of two years from the accrual of the cause of action in the absence of disability or nonresidence affecting the running of the statute. *Smith v. Finance Co. of America*, 207 N.C. 367, 177 S.E. 183 (1934).

**Same—Nonresident Creditor.**—An action for the statutory penalty for charging usury, brought against a nonresident creditor who has no agent here upon whom process may be served, is not barred by the statute of limitations, nor does the fact in such case that one of the plaintiffs is a nonresident and the other has changed his residence affect the matter. *Cuthberton v. Peoples Bank*, 170 N.C. 531, 87 S.E. 333 (1915).

**Setting Aside Fraudulent Conveyance.**—In a creditor's action to establish its debt and to have a subsequent conveyance by the debtor set aside as fraudulent as to creditors, the fact that plaintiff's debt is tainted with usury entitles defendant debtor to invoke the forfeiture of interest, but does not defeat plaintiff's action, or estop

plaintiff from asserting the equitable remedy of setting aside the fraudulent conveyance under the doctrine that he who seeks equity must come into court with clean hands. *Virginia Trust Co. v. Lambert Realty Corp.*, 215 N.C. 526, 2 S.E.2d 544 (1939).

**Restraining Foreclosure.**—The holder of a second mortgage, able and willing to pay the amount of the debt secured by the first mortgage, but alleging usury, under this section, is entitled to have a restraining order against foreclosure continued until termination of the issue of usury. *Wilson v. Union Trust Co.*, 200 N.C. 788, 158 S.E. 479 (1931).

**Borrower May Use Lender as Witness.**—To the end that the defense may be ample and complete, if the borrower in his discretion should resort to his remedy under this section he is authorized to examine the lender as a witness. *Merchants Bank v. Lutterloh*, 81 N.C. 143 (1879).

**Usury Question of Law When Facts Not in Dispute.**—What constitutes usury is a question of law to be determined by the court when the facts are not in dispute. *Grant v. Morris & Sons*, 81 N.C. 150 (1879).

**When Question for Jury.**—Where, in an action upon a note, the defendant pleads the usury statute, and the evidence is sufficient to sustain a verdict that the excess of interest was a proper charge made for negotiating the loan, the question should be submitted to the jury. *Swamp Loan & Trust Co. v. Yokley*, 174 N.C. 573, 94 S.E. 102 (1917).

If a transaction is of doubtful character it should be submitted to the jury for determination. *Carolina Industrial Bank v. Merrimon*, 260 N.C. 335, 132 S.E.2d 692 (1963).

Where the plea of the usury under this section is made by the plaintiff in the action to enjoin the defendant from the sale of land securing a mortgage note, and there is a dispute as to whether the charge made was usurious, and as to the amount due under the mortgage, it is reversible error for the trial judge to assume the correctness of the plaintiff's contentions as a fact, and take the case from the jury accordingly. *Miller v. Dunn*, 188 N.C. 379, 124 S.E. 746 (1924).

The fact that a sum borrowed was made payable to the borrowers and an attorney with allegations and evidence that the attorney under instructions from the lender deducted a certain sum therefrom before the borrowers could obtain the money, together with the "item of expense" set out

in the deed of trust securing the loan, is held sufficient to have been submitted to the jury on the question of usury. *Jonas v. Home Mortgage Co.*, 205 N.C. 89, 170 S.E. 127 (1933).

Where the plaintiff alleged usury and the defendant contended that the transaction was within the "commission for the sale of bonds" exception to the usury law, it was held that as the evidence was conflicting it was properly submitted to the jury, and was sufficient to support its verdict in plaintiff's favor. *Sherrill v. Hood*, 208 N.C. 472, 181 S.E. 330 (1935).

**Effect of Consent Judgment.**—Where a controversy between the parties as to the amount of the debt has been settled by a

consent judgment such judgment is conclusive and final as to any matter determined and cannot be impeached collaterally in another proceeding under this section. *Rector v. Suncrest Lumber Co.*, 52 F.2d 946 (4th Cir. 1931).

**Failure to Instruct as to Double Recovery Is Prejudicial.**—The plaintiff in his action to recover for usurious rate of interest paid and received by the lender is entitled under this section to recover double the amount of the interest so paid and received, and an instruction to the jury that fails to give him this right is prejudicial to him and is reversible error. *Bundy v. Commercial Credit Co.*, 200 N.C. 511, 157 S.E. 860 (1931).

**§ 24-3. Time from which interest runs.**—Interest is due and payable on instruments, as follows:

- (1) All bonds, bills, notes, bills of exchange, liquidated and settled accounts shall bear interest from the time they become due, provided such liquidated and settled accounts be signed by the debtor, unless it is specially expressed that interest is not to accrue until a time mentioned in the said writings or securities.
- (2) All bills, bonds, or notes payable on demand shall be held and deemed to be due when demandable by the creditor, and shall bear interest from the time they are demandable, unless otherwise expressed.
- (3) All securities for the payment or delivery of specific articles shall bear interest as moneyed contracts; and the articles shall be rated by the jury at the time they become due.
- (4) Bills of exchange drawn or indorsed in the State, and which have been protested, shall carry interest, not from the date thereof, but from the time of payment therein mentioned. (1786, c. 248, P. R.; 1828, c. 2; R. C., c. 13; Code, ss. 44, 45, 46, 47; Rev., s. 1952; C. S., s. 2307.)

**Cross References.** — As to commercial paper, see §§ 25-3-118 (d), 25-3-122 (4). As to money due as owelty, see § 46-11.

**Necessity of Demand.**—A person holding money belonging to another is not liable for interest thereon, except from the date of demand. *Hyman v. Gray*, 49 N.C. 155 (1856); *Neal v. Freeman*, 85 N.C. 441 (1881).

**Interest from Commencement of Action in Absence of Demand.**—Where interest runs from the date of demand, and no demand has been made, interest will be allowed from the date of commencement of suit. *Porter v. Grimsley*, 98 N.C. 550, 4 S.E. 529 (1887).

**Coupons or Installments of Interest Bear Interest from Demand.**—Coupons or installments of interest bear interest from the time of a demand of payment made after their maturity. *Burroughs v. Commissioners*, 65 N.C. 234 (1871).

**Or from Maturity if Detached.** — Coupons, when detached from the bond to which they were annexed, bear interest

from the time when they were due and payable. *Burroughs v. Commissioners*, 65 N.C. 234 (1871).

**A premium note for life insurance** at six per cent interest draws that rate from its date unless otherwise specified. *Owens v. North State Life Ins. Co.*, 173 N.C. 373, 92 S.E. 168 (1917).

**Order of County Treasurer for Payment of Money.**—Where A brought an action upon an order of a county treasurer, signed by the chairman of the board of county commissioners, it was held under this section that he was entitled to recover interest upon the amount of the order from the time of the demand of payment. *Yellowly v. Commissioners*, 73 N.C. 164 (1875).

**Bond Payable without Interest.**—Where a note or bond is made payable without interest at a certain date, interest does not run thereon except from the time when it should have been paid. *Dowd v. North Carolina R.R.*, 70 N.C. 468 (1874).

**Unliquidated Damages.** — Unliquidated damages as a general rule, and in the ab-

sence of special circumstances, do not bear interest until after their amount has been judicially ascertained. *Tilghman v. Proctor*, 125 U.S. 136, 8 Sup. Ct. 894, 31 L. Ed. 664 (1888).

When interest is recoverable on amount of verdict, it will run from the date of the verdict, unless it can be legally determined before then. *Ludford v. Combs*, 195 N.C. 851, 141 S.E. 541 (1928).

**§ 24-4. Obligations due guardians to bear compound interest; rate of interest.**—Guardians shall have power to lend any portion of the estate of their wards upon bond with sufficient security, to be repaid with interest annually, and all the bonds, notes or other obligations which he shall take as guardian shall bear compound interest, for which he must account, and he may assign the same to the ward on settlement with him. On loans made out of the estate of their wards, guardians may lend at any rate of interest not less than four per cent per annum and not more than the maximum legal rate. This section shall in no way limit or affect the powers of guardians to make other investments which are now or may hereafter be authorized or permitted by the laws, statutory or otherwise, of the State of North Carolina. (1762, c. 69, P. R.; 1816, c. 925, P. R.; R. C., c. 54, s. 23; 1868-9, c. 201, s. 29; Code, s. 1592; Rev., s. 1953; C. S., s. 2308; 1943, c. 728.)

**Security in Addition to That of Borrower Must Be Taken.**—The policy of this section is to require an investment by a guardian to be secured by the bond or note of some person in addition to the borrower. *Watson v. Holton*, 115 N.C. 36, 20 S.E. 183 (1894).

**Or Guardian Is Liable for Any Loss.**—In *Boyett v. Hurst*, 54 N.C. 167 (1854), where the guardian loaned the money of his ward to a trading firm composed of two partners, who both became insolvent at the same time, and from the same causes, no security having been taken besides the names of the two partners, it was held that the guardian was accountable for the money thus loaned, notwithstanding at the time of this loan the partners were considered as entirely solvent and their failure was sudden and unexpected.

A guardian will be held liable for any loss resulting from a loan made without taking any security, however solvent the debtor may have been when the loan was made. *Collins v. Gooch*, 97 N.C. 186, 1 S.E. 653 (1887); *Bane v. Nicholson*, 203 N.C. 104, 164 S.E. 750 (1932).

**§ 24-5. Contracts, except penal bonds, and judgments to bear interest; jury to distinguish principal.**—All sums of money due by contract of any kind, excepting money due on penal bonds, shall bear interest, and when a jury shall render a verdict therefor they shall distinguish the principal from the sum allowed as interest; and the principal sum due on all such contracts shall bear interest from the time of rendering judgment thereon until it is paid and satisfied. In like manner, the amount of any judgment or decree, except the costs, rendered or adjudged in any kind of action, though not on contract, shall bear interest till paid, and the judgment and decree of the court shall be rendered according to this section. (1786, c. 253, P. R.; 1789, c. 314, s. 4, P. R.; 1807, c. 721, P. R.; R. C., c. 31, s. 90; Code, s. 530; Rev., s. 1954; C. S., s. 2309.)

**Section Changes Common Law.** — At common law a judgment did not carry interest when an execution of sci. fa. was issued upon it. In an action upon the judg-

A guardian's primary duty is to invest the trust fund, and he will be chargeable with interest in the absence of proof that it remained in his hands unemployed without his fault. *Wilson v. Lineberger*, 88 N.C. 416 (1883).

**Calculation of Compound Interest.**—The rule for compounding interest on notes due guardians is "to make annual rests," making the aggregate of principal and interest due at the end of a particular year a new principal, bearing interest thenceforward for another year. *Ford v. Vandyke*, 33 N.C. 227 (1850); *Little v. Anderson*, 71 N.C. 190 (1874).

**Bonds Themselves May Be Transferred to Ward.** — The bonds, upon which the guardian has lent the ward's money, may be transferred by him to the ward in settlement with him, and the guardian does not have to pay the ward in money. *Cobb v. Fountain*, 187 N.C. 335, 121 S.E. 614 (1924).

Applied in *Robinson v. Ham*, 215 N.C. 24, 200 S.E. 903 (1939).



ment the plaintiff could recover interest by way of damages for the detention of the money. The statute was passed for the purpose of amending the law in this respect. *Collais v. McLeod*, 30 N.C. 221 (1848). The intent was that the principal should bear interest because it was just and right that it should, and that the technical rule of the common law should no longer stand in the way. *McNeill v. Durham & C.R.R.*, 138 N.C. 1, 50 S.E. 458 (1905).

This section is not exclusive in prescribing instances in which interest is recoverable, and in proper instances interest may be recovered upon transactions not coming within the statute. *Anderson Cotton Mills v. Royal Mfg. Co.*, 221 N.C. 500, 20 S.E.2d 818 (1942).

**Application Is to Liquidated Demands Only.**—The rule that all moneys due by contract, except those due on penal bonds, shall bear interest applies whenever a recovery is had for the breach of a contract and the amount is ascertained from the terms of the contract itself or from evidence relative to the inquiry, and due by one party to the contract to another; and it does not obtain as a matter of law where the interest sought does not come within the provisions of the statute and is by way of unliquidated damages, and there has been no adequate default on the part of the debtor in reference to withholding the principal sum, or a part of it. *Bond v. Pickett Cotton Mills*, 166 N.C. 20, 81 S.E. 936 (1914).

**Trend Is toward Allowance of Interest.**—There has been a definite trend in North Carolina toward allowance of interest in almost all types of cases involving breach of contract. *Harris & Harris Constr. Co. v. Crain & Denbo, Inc.*, 256 N.C. 110, 123 S.E.2d 590 (1962).

**Interest Is Imposed by Law in Nature of Damages.**—A debt draws interest from the date it becomes due, and when interest is not made payable on the face of the instrument, payment of interest will be imposed by law in the nature of damages for the retention of the principal of the debt. *Security Nat'l Bank v. Travelers' Ins. Co.*, 209 N.C. 17, 182 S.E. 702 (1935).

Under this section money due by contract, except money due on penal bonds, bears interest as a matter of law. *Anderson Cotton Mills v. Royal Mfg. Co.*, 221 N.C. 500, 20 S.E.2d 818 (1942).

**When Interest Added to Damages for Breach of Contract.**—Whenever a recovery is had for breach of contract and the amount of damages is ascertained from the

terms of the contract itself or from evidence relevant to the inquiry, interest should be added. *Harris & Harris Constr. Co. v. Crain & Denbo, Inc.*, 256 N.C. 110, 123 S.E.2d 590 (1962).

**Interest Allowed from Date of Breach.**—When the amount of damages in a breach of contract action is ascertained from the contract itself, or from relevant evidence, or from both, interest should be allowed from the date of the breach. *General Metals, Inc. v. Truitt Mfg. Co.*, 259 N.C. 709, 131 S.E.2d 360 (1963).

Interest on the amount of damages starts running from the date of demand by the injured party. *Harris & Harris Constr. Co. v. Crain & Denbo, Inc.*, 256 N.C. 110, 123 S.E.2d 590 (1962).

**From Time Due.**—When a real estate man is entitled to recover a reasonable amount for his services rendered in securing a tenant for a building, the sum fixed by the verdict will, as a matter of law, draw interest from the time the same was due and payable. *Thomas v. Piedmont Realty & Dev. Co.*, 195 N.C. 591, 143 S.E. 144 (1928).

**After demand by a depositor or creditor of a bank for the payment of the amount due and refusal of the bank to make payment, the bank is liable for the amount of the claim plus interest at the rate of six per centum per annum.** *Hackney v. Hood*, 203 N.C. 486, 166 S.E. 323 (1932).

**Money Wrongfully Received Draws Interest.**—"The theory upon which the plaintiff recovers is that the defendant has received the money wrongfully and the law implies a promise to repay it. The action was originally equitable in its character and founded upon the theory that in good conscience the defendant should repay the money wrongfully received, and from this duty the law implied a promise so to do. We see no reason why the amount should not draw interest. *Revisal*, § 1954 [this section]; *Barlow v. Norfleet*, 72 N.C. 535 (1875); *Farmer v. Willard*, 75 N.C. 401 (1876). The cases cited by defendant were actions in tort, wherein the jury may or may not allow interest, as they see proper. In this lies the distinction." *Hilton Lumber Co. v. Atlantic Coast Line R.R.*, 141 N.C. 171, 53 S.E. 823, 6 L.R.A., (N.S.) 225 (1906).

**Purpose of Requiring Jury to Distinguish Principal and Interest.**—The evident design of this section is to allow the plaintiff interest on the principal sum recovered in a judgment from the time of its rendition; and the direction to the jury to distinguish between the principal and in-

terest was intended to provide for those cases in which the whole sum is assessed in damages, so as to enable the clerk or the sheriff to compute the interest on the principal sum. But where the principal and interest are discriminated on the record, or it can be collected from an inspection of it what the principal sum was, it is equally within the spirit of the act that interest should be calculated on that. *DeLoach v. Worke*, 10 N.C. 36 (1824).

**Judgment Bears Interest from First Day of Term.**—Where a consent judgment for a recovery of a certain sum is made a lien on lands, and by its terms payable ninety days from its rendition, it bears interest from the first day of the term, the time given being merely for the purpose of raising the money for its payment; and where the only question submitted to the court is whether interest is chargeable from the date it was payable to a further period beyond, interest for such extended period at the rate of 6 per cent should be allowed. In *re Chisholm's Will*, 176 N.C. 211, 96 S.E. 1031 (1918).

**Where Verdict Decides Contract Issue, Judgment Should Include Interest.**—Where the controversy is made to depend upon whether a written agreement of a certain date to subscribe to plaintiff's enterprise in a sum certain was binding upon the defendant corporation, the affirmative answer of the jury to the issue carries with it interest on the subscription from the date it was due, as a matter of law, and judgment should be rendered accordingly, and not from the date of its rendition as in tort. *Chatham v. Mecklenburg Realty Co.*, 174 N.C. 671, 94 S.E. 447 (1917).

**Interest on Value of Permanent Improvements on Land.**—Where it has been ascertained by the verdict of the jury, upon a trial free from error, that the plaintiff is entitled to recover of the defendant the value of permanent improvements he has put upon the defendant's land under a parol agreement that the latter would convey a part of the lands in consideration thereof, void under the statute of frauds, to the extent that the improvements have enhanced the value of the land, interest is properly allowed in the judgment from the time of the defendant's breach, on the amount ascertained to be due at that time; and objection that the jury may have included the interest in their verdict is untenable when it appears that nothing was said by counsel or court in respect to it, the presumption being to the contrary. *Perry v. Norton*, 182 N.C. 585, 109 S.E. 641 (1921).

**Interest on Contracts and Torts Distinguished.**—Where a verdict is given in an action on contract in plaintiff's favor for moneys due by the defendant to his intestate, interest is also given the plaintiff on the amount of the recovery as a matter of law, when not incorporated in the verdict. When in tort the matter of interest is awarded or not according as the jury may find. *Thomas v. Watkins*, 193 N.C. 630, 137 S.E. 818 (1927).

**In Tort Actions Judgment for Damages Bears Interest.**—Although the allowance of interest, in an action for damages for conversion of property, is discretionary with the jury, yet, after the verdict, the judgment for the damages assessed bears interest by virtue of this section, and this is so, although the verdict is for a certain sum "without interest." *Stephens v. Koonce*, 103 N.C. 266, 9 S.E. 315 (1889).

**But interest is not allowable as a matter of law in case of tort.** Its allowance as damages rests in the discretion of the jury. *Lincoln v. Clafin*, 74 U.S. (7 Wall.) 132, 19 L. Ed. 106 (1868).

**It Is Discretionary with Jury to Include Interest in Verdict.**—In an action for damages for conversion, the verdict being for the value of the property at the time of the conversion, interest can only begin from the time of the judgment. However, the jury may allow interest on the amount of the damages from time of the conversion. *Lance v. Butler*, 135 N.C. 419, 47 S.E. 488 (1904).

The rule in this State is that interest, as interest, is allowed only when expressly given by statute, or by the express or implied agreement of the parties. *Devereux v. Burgwin*, 33 N.C. 490 (1850); *Lewis v. Rountree*, 79 N.C. 122 (1878). The only statute upon the subject is that contained in this section, which provides that all sums of money due by contract of any kind whatsoever, excepting such as may be due on penal bonds, shall bear interest, etc., but there is no provision made for actions of trover or trespass de bonis asportatis. In such cases, in order to compel the wrongdoer to make full compensation to the injured party, the jury may, in their discretion, and as damages, allow interest upon the value of the property from the time of its conversion or seizure, and it has been usual for them to do so. But there is no rule which gives it as a matter of law and right. *Patapsco v. Magee*, 86 N.C. 350 (1882).

**Judgment against State Agency.**—This section has no application to a judgment

against the State Highway Commission. *Yancey v. North Carolina State Highway & Pub. Works Comm'n*, 222 N.C. 106, 22 S.E.2d 256 (1942); *North Carolina State Highway & Pub. Works Comm'n v. Privett*, 246 N.C. 501, 99 S.E.2d 61 (1957).

**Judgment Bears Interest Though Nothing Is Said.**—By virtue of this section a judgment bears interest from the time of its rendition until paid, though nothing is said therein about interest. *McNeill v. Durham & C.R.R.*, 138 N.C. 1, 50 S.E. 458 (1905).

This section was held directory so far as it provided that the judgment must itself state that it shall bear interest from the date of rendition until it is paid. It is perfectly clear that such a statement in the judgment is not essential to effectuate the intent of the legislature, which is to allow interest on judgments. *McNeill v. Durham & C.R.R.*, 138 N.C. 1, 50 S.E. 458 (1905).

**If Judgment Enables Officer to Compute Interest.**—It is best always that the court in its judgment should state fully the amount to be raised by the execution, both principal and interest; but the plaintiff will not forfeit his right to interest by the failure to do this, when enough appears on the face of the judgment to enable the officer to compute the amount justly due. All he is required to know is the amount of the principal, and then the statute makes that amount bear interest to the time of payment. *McNeill v. Durham & C.R.R.*, 138 N.C. 1, 50 S.E. 458 (1905).

**Compromise Judgment in Will Contest.**—Where, in a will contest, a compromise judgment was entered whereby legatees named in the will were to receive certain amounts in settlement of their legacies which were ordered to be paid by the administrator cum testamento annexo thereafter to be appointed, the judgment was not such a judgment as, under this section would draw interest from its date. *Moore v. Pullen*, 116 N.C. 284, 21 S.E. 195 (1895).

**Interest on Damages in Condemnation Proceedings.**—Interest is not allowed on a judgment rendered in the superior court for damages awarded by the jury to the owner for taking his lands in condemnation; for while the jury may award interest in their verdict, the owner may not complain when such has not been done, in the absence of a special request for instructions with relation to it, and the absence of evidence tending to show he is entitled to it. *Raleigh, C. & So. R.R. v. Mecklenburg Mfg. Co.*, 166 N.C. 168, 82 S.E. 5 (1914). See *Yancey v. North Carolina*

*State Highway & Pub. Works Comm'n*, 221 N.C. 185, 19 S.E.2d 489 (1942).

**On Dividend Declared by Receiver.**—Where a receiver declares a dividend which he wrongfully withholds, interest should run from the time the dividend is declared. *Armstrong v. American Exch. Nat'l Bank*, 133 U.S. 433, 10 Sup. Ct. 450, 33 L. Ed. 747 (1890).

**Interest on Surety Bond.**—Where the surety bond of a clerk of the superior court is fixed as to amount in the sum of five thousand dollars, to that extent a surety is responsible for the defalcation of his principal, including 6 per cent interest from the time of notice given it, except from judgment thereon, when a different principal applies and the surety is liable for 6 per cent interest on the judgment until it is paid. *Lee v. Martin*, 188 N.C. 119, 123 S.E. 631 (1924).

The measure of the surety's liability is that of the principal, provided such liability does not exceed the penal sum of the bond, and where a bank gives a bond to an agency of the State to protect such agency's deposit, upon the insolvency of the bank with assets insufficient to pay depositors in full, the State agency may not hold the surety liable for interest from the time action on the bond is instituted, since in such circumstances the bank is not liable for interest, but the surety is liable for interest only from date of judgment against it on the bond on the amount for which the bank is liable to the State agency as of that date. *State v. United States Guarantee Co.*, 207 N.C. 725, 178 S.E. 550 (1935).

**Assessments against Policyholder in Mutual Insurance Company.**—In *Miller v. Barnwell Bros.*, 137 F.2d 257 (4th Cir. 1943), it was held that under this section interest should be allowed on assessments against a policyholder in a mutual insurance company under the policies in suit from the dates of the respective demands by the receiver.

**Facts Not Excusing Payment of Interest by Insurance Company.**—Where under the terms of a policy of insurance payment is to be made to the beneficiaries immediately upon receipt of due proof of death of insured, the failure of the insurer to make payment until more than a year after receipt of such due proof entitles the beneficiaries to interest on the amount from the date of insurer's receipt of due proof, and payment of interest will not be excused because payment by insurer was delayed by reason of the fact that the trust agreement under which the policy was as-



signed was changed without notice to insurer by adding an individual trustee, and the fact that the corporate trustee became insolvent before payment and a substituted trustee appointed and insurer did not have notice of such substitution until a much later date, insurer having had the use of the money during the period of delay. *Security Nat'l Bank v. Travelers' Ins. Co.*, 209 N.C. 17, 182 S.E. 702 (1935).

Where the case was erroneously nonsuited and the nonsuit reversed on appeal, plaintiffs were entitled to interest from

the first day of the term at which the nonsuit was erroneously entered. *Jackson v. Gastonia*, 247 N.C. 88, 100 S.E.2d 241 (1957).

Applied in *Red Springs City Bd. of Educ. v. McMillan*, 250 N.C. 485, 108 S.E.2d 895 (1959); *H. F. Mitchell Constr. Co. v. Orange County Bd. of Educ.*, 262 N.C. 295, 136 S.E.2d 635 (1964); *Glance v. Town of Pilot Mountain*, 265 N.C. 181, 143 S.E.2d 78 (1965).

Cited in *Bell v. Danzer*, 187 N.C. 224, 121 S.E. 448 (1924).

**§ 24-6. Clerk to ascertain interest upon default judgment on bond, covenant, bill, note or signed account.**—When a suit is instituted on a single bond, a covenant for the payment of money, bill of exchange, promissory note, or a signed account, and the defendant does not plead to issue thereon, upon judgment, the clerk of the court shall ascertain the interest due by law, without a writ of inquiry, and the amount shall be included in the final judgment of the court as damages, which judgment shall be rendered therein in the manner prescribed by § 24-5. (1797, c. 475, P. R.; R. C., c. 31, s. 91; Code, s. 531; Rev., s. 1956; C. S., s. 2310.)

This section dispenses with a jury and directs the clerk to compute the interest preparatory to a final judgment by default in suits "instituted on a single bond, a covenant for the payment of money, bill of exchange, promissory note, or a signed account," contemplating the rendition of such judgment upon written instruments which themselves specify the precise sum to be paid, and need only an estimate of accrued interest. *Rogers v. Moore*, 86 N.C. 86 (1882).

**Courts' Power to Correct Mistake in Calculation.**—A judgment by default upon a speciality, for the want of a plea, entered by the clerk in court, upon his calculation of interest, was held to be an office judgment, and that the court possessed the power to correct a mistake in the clerk's calculation of interest at any time upon motion. *Griffin v. Hinson*, 51 N.C. 154 (1858).

**§ 24-7. Interest from verdict to judgment added as costs.**—When the judgment is for the recovery of money, interest from the time of the verdict or report until judgment is finally entered shall be computed by the clerk and added to the costs of the party entitled thereto. (Code, s. 529; Rev., s. 1955; C. S., s. 2311.)

Applied in *Glance v. Town of Pilot Mountain*, 265 N.C. 181, 143 S.E.2d 78 (1965).

**§ 24-8. Loans of thirty thousand dollars or more to corporations.**—Notwithstanding any other provisions of this chapter or any other provisions of law, any foreign or domestic corporation organized for pecuniary gain may agree to pay, and any lender may charge and collect from such corporation, interest at any rate agreed upon not in excess of eight per cent (8%) per annum where the original principal amount of the loan shall equal or exceed the sum of thirty thousand dollars (\$30,000.00), or where the total principal amount to be repaid under a loan agreement or other undertaking calling for a series of advances of money shall equal or exceed the sum of thirty thousand dollars (\$30,000.00), and as to any such transaction the penalty and forfeiture of interest imposed under G.S. 24-2 shall not be available in any manner whatsoever to such corporation or its successor in interest, nor shall the principal or any part thereof be impaired or forfeited; provided, that should any individual endorser, surety or guarantor be called upon to pay all or any part of said loan, then the total amount due by such individual shall not exceed the principal balance outstanding plus

six per cent (6%) interest per annum thereon; and provided, that this section shall not be applicable to any loan which matures less than five (5) years from the date thereof or which provides for repayments of principal to be made by the borrower in an amount in excess of one fifth of the total principal indebtedness during any year of the first five (5) years of the term of such loan; nothing contained in this section shall be held or construed to prohibit corporations from doing any act or from incurring any obligation now permitted under G.S. 24-2 or any other provision of law. (1961, c. 1142.)

**§ 24-9. Certain loans to corporations organized for profit not subject to claim or defense of usury.**—Notwithstanding any other provision of this chapter or any other provision of law, any foreign or domestic corporation substantially engaged in commercial, manufacturing or industrial pursuits for pecuniary gain may agree to pay, and any commercial factor may charge and collect from such corporation, interest at any rate which such corporation may agree to pay in writing, provided such interest is charged upon loans, advances or forbearances which are secured by liens upon or security interests in accounts receivable, materials, goods in process, inventory, machinery, equipment and other similar personal property, whether tangible or intangible, and as to any such transaction the claim or defense of usury by such corporation and its successors or anyone else in its behalf is prohibited. For purpose of this section the term “commercial factor” shall be defined to mean any corporation, foreign or domestic, or any partnership which in the regular course of its business engages in the purchase of accounts receivable, without recourse to the account creditor, and with notification of such purchase to the account debtor. (1963, c. 753, s. 1; 1965, c. 335.)

**Local Modification.** — Ashe, Columbus, New Hanover and Pender: 1963, c. 753, s. 1½.

**Editor’s Note.** — The 1965 amendment inserted “or any partnership” in the last sentence.

## Chapter 25.

### Uniform Commercial Code.

#### PUBLISHERS' NOTE

Former §§ 25-1 to 25-199 (the NIL) were repealed by Session Laws 1965, c. 700, which enacted the UCC.

To maintain uniformity with the commercial codes adopted by other states, the designation and indention of subsections, subdivisions and further divisions of sections in present Chapter 25 are not changed to conform to the system and style employed elsewhere in the General Statutes. The numbering of sections corresponds to that used in the 1962 Official Text of the UCC, except that each number is preceded by the chapter number, "25." Thus, "§ 1-101" of the Official Text is "§ 25-1-101" in this chapter.

Where sections of the UCC are similar to sections repealed by Session Laws 1965, c. 700, the historical citations to the former sections have been added to the new sections.

Following the sections of Chapter 25 are annotations taken from North Carolina cases decided under such repealed sections or other prior similar law. These annotations have been placed under the new sections where it is thought they will be helpful.

In addition two sets of Comments have been included. The Comments headed "North Carolina Comment" first appeared in "North Carolina Annotations—The Uniform Commercial Code," a 1965 report of the former Legislative Council to the General Assembly of North Carolina. Appropriate comments were selected by the publishers' staff and edited to reflect the status of the law since the enactment of the UCC under the supervision of the Division of Legislative Drafting and Codification of Statutes of the Department of Justice. The Comments headed "Official Comment" are the Comments of the National Conference of Commissioners on Uniform State Laws and The American Law Institute which appear in the "1962 Official Text with Comments" of the UCC. The Comment under the title of the Act states in part: "Uniformity throughout American jurisdictions is one of the main objectives of this Code; and that objective cannot be obtained without substantial uniformity of construction. To aid in uniform construction these Comments set forth the purpose of various provisions of this Act to promote uniformity, to aid in viewing the Act as an integrated whole, and to safeguard against misconstruction." Permission to include the Official Comments was granted by the National Conference of Commissioners on Uniform State Laws and The American Law Institute. It is believed that both sets of Comments will prove of value to the practitioner in understanding and applying the text of this chapter.

#### Article 1.

##### General Provisions.

##### Part 1. Short Title, Construction, Application and Subject Matter of the Act.

Sec.

- 25-1-101. Short title.
- 25-1-102. Purposes; rules of construction; variation by agreement.
- 25-1-103. Supplementary general principles of law applicable.
- 25-1-104. Construction against implicit repeal.
- 25-1-105. Territorial application of the act; parties' power to choose applicable law.
- 25-1-106. Remedies to be liberally administered.
- 25-1-107. Waiver or renunciation of claim or right after breach.

Sec.

- 25-1-108. Severability.
- 25-1-109. Section captions.

##### Part 2. General Definitions and Principles of Interpretation.

- 25-1-201. General definitions.
- 25-1-202. Prima facie evidence by third party documents.
- 25-1-203. Obligation of good faith.
- 25-1-204. Time; reasonable time; "seasonably."
- 25-1-205. Course of dealing and usage of trade.
- 25-1-206. Statute of frauds for kinds of personal property not otherwise covered.
- 25-1-207. Performance or acceptance under reservation of rights.
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- 25-3-504. How presentment made.
- 25-3-505. Rights of party to whom presentment is made.
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- 25-3-508. Notice of dishonor.
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- 25-4-103. Variation by agreement; measure of damages; certain action constituting ordinary care.
- 25-4-104. Definitions and index of definitions.
- 25-4-105. "Depository bank"; "intermediary bank"; "collecting bank"; "payor bank"; "presenting bank"; "remitting bank."
- 25-4-106. Separate office of a bank.
- 25-4-107. Time of receipt of items.
- 25-4-108. Delays.
- 25-4-109. Process of posting.

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- 25-4-202. Responsibility for collection; when action seasonable.
- 25-4-203. Effect of instructions.
- 25-4-204. Methods of sending and presenting; sending direct to payor bank.
- 25-4-205. Supplying missing indorsement; no notice from prior indorsement.
- 25-4-206. Transfer between banks.
- 25-4-207. Warranties of customer and collecting bank on transfer or presentment of items; time for claims.
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- 25-4-209. When bank gives value for purposes of holder in due course.
- 25-4-210. Presentment by notice of item not payable by, through or at a bank; liability of secondary parties.
- 25-4-211. Media of remittance; provisional and final settlement in remittance cases.
- 25-4-212. Right of charge-back or refund.
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- 25-4-301. Deferred posting; recovery of payment by return of items; time of dishonor.
- 25-4-302. Payor bank's responsibility for late return of item.
- 25-4-303. When items subject to notice, stop-order, legal process or setoff; order in which items may be charged or certified.

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- 25-4-402. Bank's liability to customer for wrongful dishonor.
- 25-4-403. Customer's right to stop payment; burden of proof of loss.
- 25-4-404. Bank not obligated to pay check more than six months old.
- 25-4-405. Death or incompetence of customer.
- 25-4-406. Customer's duty to discover and report unauthorized signature or alteration.
- 25-4-407. Payor bank's right to subrogation on improper payment.

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- 25-4-501. Handling of documentary drafts; duty to send for presentment and to notify customer of dishonor.
- 25-4-502. Presentment of "on arrival" drafts.
- 25-4-503. Responsibility of presenting bank for documents and goods; report of reasons for dishonor; referee in case of need.
- 25-4-504. Privilege of presenting bank to deal with goods; security interest for expenses.

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- 25-5-102. Scope.
- 25-5-103. Definitions.
- 25-5-104. Formal requirements; signing.
- 25-5-105. Consideration.
- 25-5-106. Time and effect of establishment of credit.
- 25-5-107. Advice of credit; confirmation; error in statement of terms.
- 25-5-108. "Notation credit"; exhaustion of credit.
- 25-5-109. Issuer's obligation to its customer.

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- 25-5-110. Availability of credit in portions; presenter's reservation of lien or claim.
- 25-5-111. Warranties on transfer and presentment.
- 25-5-112. Time allowed for honor or rejection; withholding honor or rejection by consent; "presenter."
- 25-5-113. Indemnities.
- 25-5-114. Issuer's duty and privilege to honor; right to reimbursement.
- 25-5-115. Remedy for improper dishonor or anticipatory repudiation.
- 25-5-116. Transfer and assignment.
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- 25-6-102. "Bulk transfers"; transfers of equipment; enterprises subject to this article; bulk transfers subject to this article.
- 25-6-103. Transfers excepted from this article.
- 25-6-104. Schedule of property, list of creditors.
- 25-6-105. Notice to creditors.
- 25-6-106. Application of the proceeds.
- 25-6-107. The notice.
- 25-6-108. Auction sales; "auctioneer."
- 25-6-109. What creditors protected; credit for payment to particular creditors.
- 25-6-110. Subsequent transfers.
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##### Warehouse Receipts, Bills of Lading and Other Documents of Title.

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- 25-7-102. Definitions and index of definitions.
- 25-7-103. Relation of article to treaty, statute, tariff, classification or regulation.
- 25-7-104. Negotiable and nonnegotiable warehouse receipt bill of lading or other document of title.
- 25-7-105. Construction against negative implication.

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- 25-7-201. Who may issue a warehouse receipt; storage under government bond.

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- 25-7-202. Form of warehouse receipt; essential terms; optional terms.
- 25-7-203. Liability for non-receipt or misdescription.
- 25-7-204. Duty of care; contractual limitation of warehouseman's liability.
- 25-7-205. Title under warehouse receipt defeated in certain cases.
- 25-7-206. Termination of storage at warehouseman's option.
- 25-7-207. Goods must be kept separate; fungible goods.
- 25-7-208. Altered warehouse receipts.
- 25-7-209. Lien of warehouseman.
- 25-7-210. Enforcement of warehouseman's lien.

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- 25-7-301. Liability for non-receipt or misdescription; "said to contain"; "shipper's load and count"; improper handling.
- 25-7-302. Through bills of lading and similar documents.
- 25-7-303. Diversion; reconsignment; change of instructions.
- 25-7-304. Bills of lading in a set.
- 25-7-305. Destination bills.
- 25-7-306. Altered bills of lading.
- 25-7-307. Lien of carrier.
- 25-7-308. Enforcement of carrier's lien.
- 25-7-309. Duty of care; contractual limitation of carrier's liability.

###### Part 4. Warehouse Receipts and Bills of Lading: General Obligations.

- 25-7-401. Irregularities in issue of receipt or bill or conduct of issuer.
- 25-7-402. Duplicate receipt or bill; over-issue.
- 25-7-403. Obligation of warehouseman or carrier to deliver; excuse.
- 25-7-404. No liability for good faith delivery pursuant to receipt or bill.

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- 25-7-501. Form of negotiation and requirements of "due negotiation."
- 25-7-502. Rights acquired by due negotiation.
- 25-7-503. Document of title to goods defeated in certain cases.
- 25-7-504. Rights acquired in the absence of due negotiation; effect of diversion; seller's stoppage of delivery.
- 25-7-505. Indorser not a guarantor for other parties.

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- 25-7-506. Delivery without indorsement; right to compel indorsement.
- 25-7-507. Warranties on negotiation or transfer of receipt or bill.
- 25-7-508. Warranties of collecting bank as to documents.
- 25-7-509. Receipt or bill; when adequate compliance with commercial contract.

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- 25-8-103. Issuer's lien.
- 25-8-104. Effect of overissue; "overissue."
- 25-8-105. Securities negotiable; presumptions.
- 25-8-106. Applicability.
- 25-8-107. Securities deliverable, action for price.

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- 25-8-201. "Issuer."
- 25-8-202. Issuer's responsibility and defenses; notice of defect or defense.
- 25-8-203. Staleness as notice of defects or defenses.
- 25-8-204. Effect of issuer's restrictions on transfer.
- 25-8-205. Effect of unauthorized signature on issue.
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- 25-8-207. Rights of issuer with respect to registered owners.
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- 25-8-302. "Bona fide purchaser."
- 25-8-303. "Broker."
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- 25-8-305. Staleness as notice of adverse claims.

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- 25-8-306. Warranties on presentment and transfer.
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- 25-8-308. Indorsement, how made; special indorsement; indorser not a guarantor; partial assignment.
- 25-8-309. Effect of indorsement without delivery.
- 25-8-310. Indorsement of security in bearer form.
- 25-8-311. Effect of unauthorized indorsement.
- 25-8-312. Effect of guaranteeing signature or indorsement.
- 25-8-313. When delivery to the purchaser occurs; purchaser's broker as holder.
- 25-8-314. Duty to deliver, when completed.
- 25-8-315. Action against purchaser based upon wrongful transfer.
- 25-8-316. Purchaser's right to requisites for registration of transfer on books.
- 25-8-317. Attachment or levy upon security.
- 25-8-318. No conversion by good faith delivery.
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- 25-8-402. Assurance that indorsements are effective.
- 25-8-403. Limited duty of inquiry.
- 25-8-404. Liability and non-liability for registration.
- 25-8-405. Lost, destroyed and stolen securities.
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#### Secured Transactions; Sales of Accounts, Contract Rights and Chattel Paper.

##### Part 1. Short Title, Applicability and Definitions.

- 25-9-101. Short title.
- 25-9-102. Policy and scope of article.
- 25-9-103. Accounts, contract rights, general intangibles and equipment relating to another jurisdiction; and incoming goods already subject to a security interest.
- 25-9-104. Transactions excluded from article.



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- 25-9-105. Definitions and index of definitions.
- 25-9-106. Definitions: "Account"; "contract right"; "general intangibles."
- 25-9-107. Definitions: "Purchase money security interest."
- 25-9-108. When after-acquired collateral not security for antecedent debt.
- 25-9-109. Classification of goods; "consumer goods"; "equipment"; "farm products"; "inventory."
- 25-9-110. Sufficiency of description.
- 25-9-111. Applicability of bulk transfer laws.
- 25-9-112. Where collateral is not owned by debtor.
- 25-9-113. Security interests arising under article on sales.

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- 25-9-203. Enforceability of security interest; proceeds, formal requisites.
- 25-9-204. When security interest attaches; after-acquired property; future advances.
- 25-9-205. Use or disposition of collateral without accounting permissible.
- 25-9-206. Agreement not to assert defenses against assignee; modification of sales warranties where security agreement exists.
- 25-9-207. Rights and duties when collateral is in secured party's possession.
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- 25-9-302. When filing is required to perfect security interest; security interests to which filing provisions of this article do not apply.
- 25-9-303. When security interest is perfected; continuity of perfection.
- 25-9-304. Perfection of security interest in instruments, documents, and goods covered by documents;

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- 25-9-305. When possession by secured party perfects security interest without filing.
- 25-9-306. "Proceeds"; secured party's rights on disposition of collateral.
- 25-9-307. Protection of buyers of goods.
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- 25-9-309. Protection of purchasers of instruments and documents.
- 25-9-310. Priority of certain liens arising by operation of law.
- 25-9-311. Alienability of debtor's rights; judicial process.
- 25-9-312. Priorities among conflicting security interests in the same collateral.
- 25-9-313. Priority of security interests in fixtures.
- 25-9-314. Accessions.
- 25-9-315. Priority when goods are commingled or processed.
- 25-9-316. Priority subject to subordination.
- 25-9-317. Secured party not obligated on contract of debtor.
- 25-9-318. Defenses against assignee; modification of contract after notification of assignment; term prohibiting assignment ineffective; identification and proof of assignment.

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- 25-9-401. Place of filing; erroneous filing; removal of collateral.
- 25-9-402. Formal requisites of financing statement; amendments.
- 25-9-403. What constitutes filing; duration of filing; effect of lapsed filing; duties of filing officer.
- 25-9-404. Termination statement.
- 25-9-405. Assignment of security interest; duties of filing officer; fees.
- 25-9-406. Release of collateral; duties of filing officer; fees.
- 25-9-407. Information from filing officer.
- 25-9-408. Recording of financing statement and security agreement in lieu of filing.

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- 25-9-501. Default; procedure when security agreement covers both real and personal property.
- 25-9-502. Collection rights of secured party.

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25-9-503. Secured party's right to take possession after default.

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25-9-504. Secured party's right to dispose of collateral after default; effect of disposition.

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25-9-505. Compulsory disposition of collateral; acceptance of the collateral as discharge of obligation.

25-10-102. Specific repealer; provision for transition.

25-10-103. General repealer.

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25-9-506. Debtor's right to redeem collateral.

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25-10-106. Covered transactions not subject to prior registration statutes.

25-9-507. Secured party's liability for failure to comply with this part.

25-10-107. Excluded transactions subject to existing statutes.

## ARTICLE 1.

*General Provisions.*

## PART 1.

## SHORT TITLE, CONSTRUCTION, APPLICATION AND SUBJECT MATTER OF THE ACT.

§ 25-1-101. **Short title.**—This chapter shall be known and may be cited as Uniform Commercial Code. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

Each Article of the Code (except this Article and Article 10) may also be cited by its own short title. See Sections 2—101.

3—101, 4—101, 5—101, 6—101, 7—101, 8—101 and 9—101.

§ 25-1-102. **Purposes; rules of construction; variation by agreement.**—(1) This chapter shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this chapter are

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

(3) The effect of provisions of this chapter may be varied by agreement, except as otherwise provided in this chapter and except that the obligations of good faith, diligence, reasonableness and care prescribed by this chapter may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

(4) The presence in certain provisions of this chapter of the words "unless otherwise agreed" or words of similar import does not imply that the effect of other provisions may not be varied by agreement under subsection (3).

(5) In this chapter unless the context otherwise requires

(a) words in the singular number include the plural, and in the plural include the singular;

(b) words of the masculine gender include the feminine and the neuter, and when the sense so indicates words of the neuter gender may refer to any gender. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 74, Uniform Sales Act; Section 57, Uniform Warehouse Receipts Act; Section 52, Uniform Bills of Lading Act; Section 19, Uniform Stock Transfer Act.

**Changes:** Rephrased and new material added.

**Purposes of changes:**

1. Subsections (1) and (2) are intended to make it clear that:

This Act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the Act requires that its interpretation and application be limited to its reason.

Courts have been careful to keep broad acts from being hampered in their effects by later acts of limited scope. *Pacific Wool Growers v. Draper & Co.*, 158 Or. 1, 73 P.2d 1391 (1937), and compare Section 1—104. They have recognized the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the act, *Commercial Nat. Bank of New Orleans v. Canal-Louisiana Bank & Trust Co.*, 239 U.S. 520, 36 S.Ct. 194, 60 L.Ed. 417 (1916) (bona fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature). They have done the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general. *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act change in seller's remedies applied to contract for sale of choses in action even though the general coverage of that Act was intentionally limited to goods "other than things in action.") They have implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They have disregarded a statutory limitation of remedy where the reason of the limitation did not apply. *Fitterman v. J. N. Johnson & Co.*, 156 Minn. 201, 194 N.W. 399 (1923) (requirement of return of the goods as a condition to rescission for breach of warranty; also, partial rescission allowed). Nothing in this Act stands in the way of the continuance of such action by the courts.

The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be

read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

2. Subsection (3) states affirmatively at the outset that freedom of contract is a principle of the Code: "the effect" of its provisions may be varied by "agreement." The meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. But the Code seeks to avoid the type of interference with evolutionary growth found in *Manhattan Co. v. Morgan*, 242 N. Y. 38, 150 N.E. 594 (1926). Thus private parties cannot make an instrument negotiable within the meaning of Article 3 except as provided in Section 3—104; nor can they change the meaning of such terms as "bona fide purchaser," "holder in due course," or "due negotiation," as used in this Act. But an agreement can change the legal consequences which would otherwise flow from the provisions of the Act. "Agreement" here includes the effect given to course of dealing, usage of trade and course of performance by Sections 1—201, 1—205 and 2—208; the effect of an agreement on the rights of third parties is left to specific provisions of this Act and to supplementary principles applicable under the next section. The rights of third parties under Section 9—301 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.

This principle of freedom of contract is subject to specific exceptions found elsewhere in the Act and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in Section 2—201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the "contract" made unenforceable; Section 9—501(3), on the other hand, is quite explicit. Under the exception for "the obligations of good faith, diligence, reasonableness and care prescribed by this Act," provisions of the Act prescribing such obligations are not to be disclaimed. However, the section also recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are



unreasonable, the agreement controls. In this connection, Section 1—205 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.

3. Subsection (4) is intended to make it clear that, as a matter of drafting, words such as “unless otherwise agreed” have been used to avoid controversy as to whether the subject matter of a particular

section does or does not fall within the exceptions to subsection (3), but absence of such words contains no negative implication since under subsection (3) the general and residual rule is that the effect of all provisions of the Act may be varied by agreement.

4. Subsection (5) is modelled on 1 U.S.C. Section 1 and New York General Construction Law Sections 22 and 35.

#### NORTH CAROLINA COMMENT

*Subsection (1):* Some of the uniform laws previously adopted are in accord: GS 27-3, 55-93. As to the Bulk Sales Law, North Carolina followed a strict construction. *Swift & Co. v. Tempelos*, 178 N.C. 487, 101 S.E. 8 (1919).

*Subsection (2):* This is new except as to paragraph (c). As to paragraph (c)

being in accord with prior law, see GS 27-3, 36-44, 36-50 and 55-93.

*Subsection (3):* Generally, one can contract except where contrary to public policy. The idea of this subsection is not explicitly set out in previous statutes.

*Subsection (4):* This subsection is new.

*Subsection (5):* Similar to GS 12-3 (1).

**§ 25-1-103. Supplementary general principles of law applicable.**—Unless displaced by the particular provisions of this chapter, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions. (1917, c. 37, s. 56; C. S., s. 4039; 1941, c. 353, s. 18; G. S., s. 55-98; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 2 and 73, Uniform Sales Act; Section 196, Uniform Negotiable Instruments Act; Section 56, Uniform Warehouse Receipts Act; Section 51, Uniform Bills of Lading Act; Section 18, Uniform Stock Transfer Act.

**Changes:** Rephrased, the reference to “estoppel” and “validating” being new.

##### Purposes of changes:

1. While this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act, the principle has been stated in more detail and the phrasing enlarged to make it clear that the “validating”, as well as the “invalidating” causes referred to in the prior uniform statutory provisions, are included here. “Validating” as used here in conjunction with “invalidating” is not intended as a narrow word confined to original valida-

tion, but extends to cover any factor which at any time or in any manner renders or helps to render valid any right or transaction.

2. The general law of capacity is continued by express mention to make clear that Section 2 of the old Uniform Sales Act (omitted in this Act as stating no matter not contained in the general law) is also consolidated in the present section. Hence, where a statute limits the capacity of a non-complying corporation to sue, this is equally applicable to contracts of sale to which such corporation is a party.

3. The listing given in this section is merely illustrative; no listing could be exhaustive. Nor is the fact that in some sections particular circumstances have led to express reference to other fields of law intended at any time to suggest the negation of the general application of the principles of this section.

#### NORTH CAROLINA COMMENT

This section is similar to provisions in a number of prior uniform laws: GS 27-4, 55-92.

**§ 25-1-104. Construction against implicit repeal.**—This chapter being a general chapter intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

Prior uniform statutory provision: None.

**Purposes:**

To express the policy that no Act which bears evidence of carefully considered permanent regulative intention should lightly be regarded as impliedly repealed by subsequent legislation. This Act, carefully integrated and intended as a

uniform codification of permanent character covering an entire "field" of law, is to be regarded as particularly resistant to implied repeal. See *Pacific Wool Growers v. Draper & Co.*, 158 Or. 1, 73 P.2d 1391 (1937).

**NORTH CAROLINA COMMENT**

This is new, but is in accord with language often used by the court indicating it does not favor repeal by implication.

*State Bd. of Agriculture v. White Oak Buckle Drainage Dist.*, 177 N.C. 222, 98 S.E. 597 (1919).

**§ 25-1-105. Territorial application of the act; parties' power to choose applicable law.**—(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this State and also to another state or nation the parties may agree that the law either of this State or of such other state or nation shall govern their rights and duties. Failing such agreement this chapter applies to transactions bearing an appropriate relation to this State.

(2) Where one of the following provisions of this chapter specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. § 25-2-402.

Applicability of the article on bank deposits and collections. § 25-4-102.

Bulk transfers subject to the article on bulk transfers. § 25-6-102.

Applicability of the article on investment securities. § 25-8-106.

Policy and scope of the article on secured transactions. §§ 25-9-102 and 25-9-103. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. Subsection (1) states affirmatively the right of the parties to a multi-state transaction or a transaction involving foreign trade to choose their own law. That right is subject to the firm rules stated in the six sections listed in subsection (2), and is limited to jurisdictions to which the transaction bears a "reasonable relation." In general, the test of "reasonable relation" is similar to that laid down by the Supreme Court in *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403, 47 S.Ct. 626, 71 L. Ed. 1123 (1927). Ordinarily the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs. But an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen.

2. Where there is no agreement as to the governing law, the Act is applicable to any transaction having an "appropriate" relation to any state which enacts it. Of

course the Act applies to any transaction which takes place in its entirety in a state which has enacted the Act. But the mere fact that suit is brought in a state does not make it appropriate to apply the substantive law of that state. Cases where a relation to the enacting state is not "appropriate" include, for example, those where the parties have clearly contracted on the basis of some other law, as where the law of the place of contracting and the law of the place of contemplated performance are the same and are contrary to the law under the Code.

3. Where a transaction has significant contacts with a state which has enacted the Act and also with other jurisdictions, the question what relation is "appropriate" is left to judicial decision. In deciding that question, the court is not strictly bound by precedents established in other contexts. Thus a conflict-of-laws decision refusing to apply a purely local statute or rule of law to a particular multi-state transaction may not be valid precedent for refusal to apply the Code in an analogous situation. Application of the Code in such circumstances may be justified by its comprehensiveness, by the policy of uniformity, and by the fact that it is in

large part a reformulation and restatement of the law merchant and of the understanding of a business community which transcends state and even national boundaries. Compare *Global Commerce Corp. v. Clark-Babbitt Industries, Inc.*, 239 F.2d 716, 719 (2d Cir. 1956). In particular, where a transaction is governed in large part by the Code, application of another law to some detail of performance because of an accident of geography may violate the commercial understanding of the parties.

4. The Act does not attempt to prescribe choice-of-law rules for states which do not enact it, but this section does not

prevent application of the Act in a court of such a state. Common-law choice of law often rests on policies of giving effect to agreements and of uniformity of result regardless of where suit is brought. To the extent that such policies prevail, the relevant considerations are similar in such a court to those outlined above.

5. Subsection (2) spells out essential limitations on the parties' right to choose the applicable law. Especially in Article 9 parties taking a security interest or asked to extend credit which may be subject to a security interest must have sure ways to find out whether and where to file and where to look for possible existing filings.

### NORTH CAROLINA COMMENT

*Subsection (1)* is one of the most important preliminary sections of the Official Uniform Commercial Code. It is believed that it modifies our conflict of laws rules. Our court has had a tendency to use rigid rules in this area. See *W. H. Morris & Sons v. Hockaday*, 94 N.C. 286 (1886); *Bundy v. Commerical Credit Co.*, 200 N.C. 511, 157 S.E. 860 (1931). The second sentence provides that where there is no agreement as to the law that will govern, and where there is sufficient relation to North Carolina, North Carolina law will be used. This may be a modification of prior law. See *Roomy v. Allstate*

*Ins. Co.*, 256 N.C. 318, 123 S.E.2d 817 (1961); *Davis v. Coleman*, 33 N.C. 303 (1850).

*Subsection (2)*: The specific conflict of laws rule set out in this section is new. This subsection states a second limitation upon the general right to select the law governing a transaction. The rationale of all five of the exceptions set forth is two-fold: (1) The necessity of certainty as to the applicable law exists in the five instances and (2) the inalienability by the contracting parties of rights of third parties, generally creditors, under local law.

**§ 25-1-106. Remedies to be liberally administered.**—(1) The remedies provided by this chapter shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this chapter or by other rule of law.

(2) Any right or obligation declared by this chapter is enforceable by action unless the provision declaring it specifies a different and limited effect. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Subsection (1)—none; Subsection (2)—Section 72, Uniform Sales Act.

**Changes:** Reworded.

**Purposes of changes and new matter:** Subsection (1) is intended to effect three things:

1. First, to negate the unduly narrow or technical interpretation of some remedial provisions of prior legislation by providing that the remedies in this Act are to be liberally administered to the end stated in the section. Second, to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the Act elsewhere makes it clear that damages must be minimized. Cf. Sections 1—203, 2—706(1), and 2—

712(2). The third purpose of subsection (1) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. Section 2—204(3).

2. Under subsection (2) any right or obligation described in this Act is enforceable by court action, even though no remedy may be expressly provided, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1—103, 2—716.



3. "Consequential" or "special" damages and "penal" damages are not defined in terms in the Code, but are used in the sense given them by the leading cases on the subject.

**Cross references:** Sections 1—103, 1—203, 2—204(3), 2—701, 2—706(1), 2—712(2) and 2—716.

**Definitional cross references:**

"Action". Section 1—201.  
 "Aggrieved party". Section 1—201.  
 "Party". Section 1—201.  
 "Remedy". Section 1—201.  
 "Rights". Section 1—201.

**NORTH CAROLINA COMMENT**

*Subsection (1)* is new. However, it is similar to a general statement of damages. See Restatement, Contracts §§ 328-45 (1932).

*Subsection (2)* is new.

§ 25-1-107. **Waiver or renunciation of claim or right after breach.**—Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Compare Section 1, Uniform Written Obligations Act; Sections 119(3), 120(2) and 122, Uniform Negotiable Instruments Law.

**Purposes:**

This section makes consideration unnecessary to the effective renunciation or waiver of rights or claims arising out of an alleged breach of a commercial contract where such renunciation is in writing and signed and delivered by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith. (Section 1—203). There may, of course, also be an oral renunciation or waiver sus-

tained by consideration but subject to Statute of Frauds provisions and to the section of Article 2 on Sales dealing with the modification of signed writings (Section 2—209). As is made express in the latter section this Act fully recognizes the effectiveness of waiver and estoppel.

**Cross references:**

Sections 1—203, 2—201 and 2—209. And see Section 2—719.

**Definitional cross references:**

"Aggrieved party". Section 1—201.  
 "Rights". Section 1—201.  
 "Signed". Section 1—201.  
 "Written". Section 1—201.

**NORTH CAROLINA COMMENT**

This section modifies prior law. Mitchell v. Sawyer, 71 N.C. 70 (1874). Except to the extent that GS 1-540, which modifies the consideration requirement to some extent, allows a release without con-

sideration, this is new. The language would not seem to apply to a release "where an agreement is made and accepted for a less amount than that demanded or claimed . . . ."

§ 25-1-108. **Severability.**—If any provision or clause of this chapter or application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of the chapter which can be given effect without the invalid provision or application, and to this end the provisions of this chapter are declared to be severable. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

This is the model severability section recommended by the National Conference of Commissioners on Uniform State Laws for inclusion in all acts of extensive scope.

**Definitional cross reference:**

"Person". Section 1—201.

§ 25-1-109. **Section captions.**—Section captions are parts of this chapter. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** that section captions are a part of the text of this Act and not mere surplusage.

**None.**

**Purposes:**

To make explicit in all jurisdictions

**NORTH CAROLINA COMMENT**

This section is contrary to prior law.  
Sims v. Charlotte Liberty Mut. Ins. Co.,  
257 N.C. 32, 125 S.E.2d 326 (1962).

**PART 2.****GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION.**

§ 25-1-201. **General definitions.**—Subject to additional definitions contained in the subsequent articles of this chapter which are applicable to specific articles or parts thereof, and unless the context otherwise requires, in this chapter:

(1) “Action” in the sense of a judicial proceeding includes recoupment, counterclaim, set-off, suit in equity and any other proceedings in which rights are determined.

(2) “Aggrieved party” means a party entitled to resort to a remedy.

(3) “Agreement” means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this chapter (§§ 25-1-205 and 25-2-208). Whether an agreement has legal consequences is determined by the provisions of this chapter, if applicable; otherwise by the law of contracts (§ 25-1-103). (Compare “Contract.”)

(4) “Bank” means any person engaged in the business of banking.

(5) “Bearer” means the person in possession of an instrument, document of title, or security payable to bearer or indorsed in blank.

(6) “Bill of lading” means a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods, and includes an airbill. “Airbill” means a document serving for air transportation as a bill of lading does for marine or rail transportation, and includes an air consignment note or air waybill.

(7) “Branch” includes a separately incorporated foreign branch of a bank.

(8) “Burden of establishing a fact” means the burden of persuading the triers of fact that the existence of the fact is more probable than its nonexistence.

(9) “Buyer in ordinary course of business” means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. “Buying” may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) “Conspicuous”: A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: **NONNEGOTIABLE BILL OF LADING**) is conspicuous. Language in the body of a form is “conspicuous” if it is in larger or other contrasting type or color. But in a telegram any stated term is “conspicuous.” Whether a term or clause is “conspicuous” or not is for decision by the court.

(11) “Contract” means the total legal obligation which results from the parties’ agreement as affected by this chapter and any other applicable rules of law. (Compare “Agreement.”)

(12) “Creditor” includes a general creditor, a secured creditor, a lien creditor and any representative of creditors, including an assignee for the benefit of credi-

tors, a trustee in bankruptcy, a receiver in equity and an executor or administrator of an insolvent debtor's or assignor's estate.

(13) "Defendant" includes a person in the position of defendant in a cross action or counterclaim.

(14) "Delivery" with respect to instruments, documents of title, chattel paper or securities means voluntary transfer of possession.

(15) "Document of title" includes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

(16) "Fault" means wrongful act, omission or breach.

(17) "Fungible" with respect to goods or securities means goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit. Goods which are not fungible shall be deemed fungible for the purposes of this chapter to the extent that under a particular agreement or document unlike units are treated as equivalents.

(18) "Genuine" means free of forgery or counterfeiting.

(19) "Good faith" means honesty in fact in the conduct or transaction concerned.

(20) "Holder" means a person who is in possession of a document of title or an instrument or an investment security drawn, issued or indorsed to him or to his order or to bearer or in blank.

(21) To "honor" is to pay or to accept and pay, or where a credit so engages to purchase or discount a draft complying with the terms of the credit.

(22) "Insolvency proceedings" includes any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved.

(23) A person is "insolvent" who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the Federal Bankruptcy Law.

(24) "Money" means a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency.

(25) A person has "notice" of a fact when

(a) he has actual knowledge of it; or

(b) he has received a notice or notification of it; or

(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.

A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. "Discover" or "learn" or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by this chapter.

(26) A person "notifies" or "gives" a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person "receives" a notice or notification when

(a) it comes to his attention; or

(b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.

(27) Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time



when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

(28) "Organization" includes a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common property interest, or any other legal or commercial entity.

(29) "Party," as distinct from "third party," means a person who has engaged in a transaction or made an agreement within this chapter.

(30) "Person" includes an individual or an organization (See § 25-1-102).

(31) "Presumption" or "presumed" means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its nonexistence.

(32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property.

(33) "Purchaser" means a person who takes by purchase.

(34) "Remedy" means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

(35) "Representative" includes an agent, an officer of a corporation or association, and a trustee, executor or administrator of an estate, or any other person empowered to act for another.

(36) "Rights" includes remedies.

(37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (§ 25-2-401) is limited in effect to a reservation of a "security interest." The term also includes any interest of a buyer of accounts, chattel paper, or contract rights which is subject to article 9. The special property interest of a buyer of goods on identification of such goods to a contract for sale under § 25-2-401 is not a "security interest," but a buyer may also acquire a "security interest" by complying with article 9. Unless a lease or consignment is intended as security, reservation of title thereunder is not a "security interest" but a consignment is in any event subject to the provisions on consignment sales (§ 25-2-326). Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

(38) "Send" in connection with any writing or notice means to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and in the case of an instrument to an address specified thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances. The receipt of any writing or notice within the time at which it would have arrived if properly sent has the effect of a proper sending.

(39) "Signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing.

(40) "Surety" includes guarantor.

(41) "Telegram" includes a message transmitted by radio, teletype, cable, any mechanical method of transmission, or the like.

(42) "Term" means that portion of an agreement which relates to a particular matter.

(43) "Unauthorized" signature or indorsement means one made without actual, implied or apparent authority and includes a forgery.

(44) "Value." Except as otherwise provided with respect to negotiable instruments and bank collections (§§ 25-3-303, 25-4-208 and 25-4-209) a person gives "value" for rights if he acquires them

(a) in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; or

(b) as security for or in total or partial satisfaction of a pre-existing claim; or

(c) by accepting delivery pursuant to a pre-existing contract for purchase; or

(d) generally, in return for any consideration sufficient to support a simple contract.

(45) "Warehouse receipt" means a receipt issued by a person engaged in the business of storing goods for hire.

(46) "Written" or "writing" includes printing, typewriting or any other intentional reduction to tangible form. (1899, c. 733, ss. 25, 56, 191; Rev., ss. 2173, 2205, 2340, 3032; 1917, c. 37, ss. 4, 5, 58; 1919, c. 65, ss. 1, 10, 32, 42; c. 290; C. S., ss. 280, 283, 292, 314, 2976, 3005, 3037, 4037, 4044, 4046; 1941, c. 353, s. 22; G. S., s. 55-102; 1955, c. 1371, s. 2; 1961, c. 574; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision, changes and new matter:**

1. "Action". See similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act. The definition has been rephrased and enlarged.

2. "Aggrieved party". New.

3. "Agreement". New. As used in this Act the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of this Act to displace a stated rule of law.

4. "Bank". See Section 191, Uniform Negotiable Instruments Law.

5. "Bearer". From Section 191, Uniform Negotiable Instruments Law. The prior definition has been broadened.

6. "Bill of Lading". See similar definitions in Section 1, Uniform Bills of Lading Act. The definition has been enlarged to include freight forwarders' bills and bills issued by contract carriers as well as those issued by common carriers. The definition of airbill is new.

7. "Branch". New.

8. "Burden of establishing a fact". New.

9. "Buyer in ordinary course of business". From Section 1, Uniform Trusts Receipts Act. The definition has been expanded to make clear the type of person protected. Its major significance lies in

Section 2—403 and in the Article on Secured Transactions (Article 9).

10. "Conspicuous". New. This is intended to indicate some of the methods of making a term attention-calling. But the test is whether attention can reasonably be expected to be called to it.

11. "Contract". New. But see Sections 3 and 71, Uniform Sales Act.

12. "Creditor". New.

13. "Defendant". From Section 76, Uniform Sales Act. Rephrased.

14. "Delivery". Section 76, Uniform Sales Act. Section 191, Uniform Negotiable Instruments Law. Section 58, Uniform Warehouse Receipts Act and Section 53, Uniform Bills of Lading Act.

15. "Document of title". From Section 76, Uniform Sales Act, but rephrased to eliminate certain ambiguities. Thus, by making it explicit that the obligation or designation of a third party as "bailee" is essential to a document of title, this definition clearly rejects any such result as obtained in *Hixson v. Ward*, 254 Ill. App. 505 (1929), which treated a conditional sales contract as a document of title. Also the definition is left open so that new types of documents may be included. It is unforeseeable what documents may one day serve the essential purpose now filled by warehouse receipts and bills of lading. Truck transport has already opened up problems which do not fit the patterns of practice resting upon the assumption that a draft can move through banking channels faster than the goods



themselves can reach their destination. There lie ahead air transport and such probabilities as teletype transmission of what may some day be regarded commercially as "Documents of Title". The definition is stated in terms of the function of the documents with the intention that any document which gains commercial recognition as accomplishing the desired result shall be included within its scope. Fungible goods are adequately identified within the language of the definition by identification of the mass of which they are a part.

Dock warrants were within the Sales Act definition of document of title apparently for the purpose of recognizing a valid tender by means of such paper. In current commercial practice a dock warrant or receipt is a kind of interim certificate issued by steamship companies upon delivery of the goods at the dock, entitling a designated person to have issued to him at the company's office a bill of lading. The receipt itself is invariably nonnegotiable in form although it may indicate that a negotiable bill is to be forthcoming. Such a document is not within the general compass of the definition, although trade usage may in some cases entitle such paper to be treated as a document of title. If the dock receipt actually represents a storage obligation undertaken by the shipping company, then it is a warehouse receipt within this section regardless of the name given to the instrument.

The goods must be "described", but the description may be by marks or labels and may be qualified in such a way as to disclaim personal knowledge of the issuer regarding contents or condition. However, baggage and parcel checks and similar "tokens" of storage which identify stored goods only as those received in exchange for the token are not covered by this Article.

The definition is broad enough to include an airway bill.

16. "Fault". From Section 76, Uniform Sales Act.

17. "Fungible". See Sections 5, 3 and 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act. Fungibility of goods "by agreement" has been added for clarity and accuracy. As to securities, see Section 8—107 and Comment.

18. "Genuine". New.

19. "Good faith". See Section 76(2), Uniform Sales Act; Section 58(2), Uniform Warehouse Receipts Act; Section 53(2), Uniform Bills of Lading Act; Section 22(2), Uniform Stock Transfer Act. "Good faith", whenever it is used in the Code,

means at least what is here stated. In certain Articles, by specific provision, additional requirements are made applicable. See, e. g., Secs. 2—103(1) (b), 7—404. To illustrate, in the Article on Sales, Section 2—103, good faith is expressly defined as including in the case of a merchant observance of reasonable commercial standards of fair dealing in the trade, so that throughout that Article wherever a merchant appears in the case an inquiry into his observance of such standards is necessary to determine his good faith.

20. "Holder". See similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act.

21. "Honor". New.

22. "Insolvency proceedings". New.

23. "Insolvent". Section 76(3), Uniform Sales Act. The three tests of insolvency—"ceased to pay his debts in the ordinary course of business," "cannot pay his debts as they become due," and "insolvent within the meaning of the federal bankruptcy law"—are expressly set up as alternative tests and must be approached from a commercial standpoint.

24. "Money". Section 6(5), Uniform Negotiable Instruments Law. The test adopted is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.

25. "Notice". New. Compare N.I.L. Sec. 56. Under the definition a person has notice when he has received a notification of the fact in question. But by the last sentence the act leaves open the time and circumstances under which notice or notification may cease to be effective. Therefore such cases as *Graham v. White-Phillips Co.*, 296 U. S. 27, 56 S. Ct. 21, 80 L. Ed. 20 (1935), are not overruled.

26. "Notifies". New. This is the word used when the essential fact is the proper dispatch of the notice, not its receipt. Compare "Send". When the essential fact is the other party's receipt of the notice, that is stated. The second sentence states when a notification is received.

27. New. This makes clear that reason to know, knowledge, or a notification, although "received" for instance by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it



was or should have been communicated to the individual conducting that transaction.

28. "Organization". This is the definition of every type of entity or association, excluding an individual, acting as such. Definitions of "person" were included in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. The definition of "organization" given here includes a number of entities or associations not specifically mentioned in prior definition of "person", namely, government, governmental subdivision or agency, business trust, trust and estate.

29. "Party". New. Mention of a party includes, of course, a person acting through an agent. However, where an agent comes into opposition or contrast to his principal, particular account is taken of that situation.

30. "Person". See Comment to definition of "Organization". The reference to Section 1—102 is to subsection (5) of that section.

31. "Presumption". New.

32. "Purchase". Section 58, Uniform Warehouse Receipts Act; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. Rephrased.

33. "Purchaser". Section 58, Uniform Warehouse Receipts Act; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. Rephrased.

34. "Remedy" New. The purpose is to make it clear that both remedy and rights (as defined) include those remedial rights of "self help" which are among the most important bodies of rights under this Act, remedial rights being those to which an aggrieved party can resort on his own motion.

35. "Representative". New.

36. "Rights". New. See Comment to "Remedy".

37. "Security Interest". See Section 1, Uniform Trust Receipts Act. The present definition is elaborated, in view especially of the complete coverage of the subject in Article 9. Notice that in view of the Article the term includes the interest of certain outright buyers of certain kinds of property. The last two sentences give guidance on the question whether reservation of title under a particular lease of

personal property is or is not a security interest.

38. "Send". New. Compare "notifies".

39. "Signed". New. The inclusion of authentication in the definition of "signed" is to make clear that as the term is used in this Act a complete signature is not necessary. Authentication may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible authentications can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with present intention to authenticate the writing.

40. "Surety". New.

41. "Telegram". New.

42. "Term". New.

43. "Unauthorized". New.

44. "Value". See Sections 25, 26, 27, 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 58, Uniform Warehouse Receipts Act; Section 22(1), Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. All the Uniform Acts in the commercial law field (except the Uniform Conditional Sales Act) have carried definitions of "value". All those definitions provided that value was any consideration sufficient to support a simple contract, including the taking of property in satisfaction of or as security for a pre-existing claim. Subsections (a), (b) and (d) in substance continue the definitions of "value" in the earlier acts. Subsection (c) makes explicit that "value" is also given in a third situation: where a buyer by taking delivery under a pre-existing contract converts a contingent into a fixed obligation.

This definition is not applicable to Articles 3 and 4, but the express inclusion of immediately available credit as value follows the separate definitions in those Articles. See Sections 4—208, 4—209, 3—303. A bank or other financing agency which in good faith makes advances against property held as collateral becomes a bona fide purchaser of that property even though provision may be made for charge-back in case of trouble. Checking credit is "immediately available" within the meaning of this section if the bank would be subject to an action for slander of credit in case checks drawn against the credit were dishonored, and when a charge-back is not discretionary with the

bank, but may only be made when difficulties in collection arise in connection with the specific transaction involved.

45. "Warehouse receipt". See Section 76(1), Uniform Sales Act; Section 1, Uniform Warehouse Receipts Act. Receipts issued by a field warehouse are included,

provided the warehouseman and the depositor of the goods are different persons.

46. "Written" or "writing". This is a broadening of the definition contained in Section 191 of the Uniform Negotiable Instruments Law.

### NORTH CAROLINA COMMENT

*Subsection (1), "Action":* Similar definitions were in GS 21-1, 25-1 and 27-2. However, broadened to include "recoupment" and "any other proceedings in which rights are determined."

*Subsection (4), "Bank":* Similar to GS 25-1 provision that "person" means association of persons unincorporated or incorporated.

*Subsection (5), "Bearer":* Similar to GS 25-1, but with a broader meaning.

*Subsection (6), "Bill of lading":* See GS 21-1, 21-4. The definition is not restricted to intrastate shipments as was the prior law.

*Subsection (9), "Buyer in ordinary course of business":* Similar to GS 45-46.

*Subsection (13), "Defendant":* Compare with GS 1-10.

*Subsection (14), "Delivery":* Similar to GS 25-1, 27-2.

*Subsection (15), "Document of title":* This subsection is new.

*Subsection (16), "Fault":* This subsection is new.

*Subsection (17), "Fungible":* See similar definition in *Edwards v. Cleveland Mill & Power Co.*, 193 N.C. 780, 138 S.E. 131 (1927). See also GS 27-2. The second sentence is new.

*Subsection (19), "Good faith":* Similar to GS 27-2, 55-96 (b).

*Subsection (20), "Holder":* Similar to GS 21-1, 25-1, 27-2.

*Subsection (23), "Insolvent":* This definition is different from that found in *Flowers v. American Agricultural Chem. Co.*, 199 N.C. 456, 154 S.E. 736 (1930).

The definition in that case suggests that "if the entire assets of a person equal or exceed his entire debts, he is solvent."

*Subsection (24), "Money":* This subsection is new.

*Subsection (25), "Notice":* Compare GS 21-11, 21-33, 25-62.

*Subsection (27), "Notice, knowledge or a notice or notification" when effective:* Somewhat similar to GS 21-11, 21-33.

*Subsection (28), "Organization":* "Person" is defined in GS 21-1, 25-1, 27-2, 45-46 and 55-96.

*Subsection (30), "Person":* See Official Comment to subsection (28).

*Subsection (32), "Purchase":* See GS 21-1, 27-2, 45-46 and 55-96. UCC definition seems broader than prior definitions.

*Subsection (33), "Purchaser":* See subsection (32) and North Carolina Comment.

*Subsection (37), "Security interest":* Compare with GS 45-46.

*Subsection (39), "Signed":* This is new, but see *Lee v. Parker*, 171 N.C. 144, 88 S.E. 217 (1916).

*Subsection (40), "Surety":* This seems to vary the meaning set out in *Wachovia Bank & Trust Co. v. Clifton*, 203 N.C. 483, 166 S.E. 334 (1932).

*Subsection (44), "Value":* Similar to GS 25-1, 25-30, 27-2, 55-96. See also GS 45-46.

*Subsection (45), "Warehouse receipt":* This is new, but see GS 27-8, 27-10.

*Subsection (46), "Written" or "writing":* A broader term than that found in GS 12-3 (10) and 25-1.

**§ 25-1-202. Prima facie evidence by third party documents.**—A document in due form purporting to be a bill of lading, policy or certificate of insurance, official weigher's or inspector's certificate, consular invoice, or any other document authorized or required by the contract to be issued by a third party shall be prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. This section is designed to supply judicial recognition for documents which have traditionally been relied upon as trustworthy by commercial men.

2. This section is concerned only with documents which have been given a preferred status by the parties themselves who have required their procurement in the agreement and for this reason the applicability of the section is limited to

actions arising out of the contract which authorized or required the document. The documents listed are intended to be illustrative and not all inclusive.

3. The provisions of this section go no further than establishing the documents in question as prima facie evidence and leave to the court the ultimate determination of

the facts where the accuracy or authenticity of the documents is questioned. In this connection the section calls for a commercially reasonable interpretation.

**Definitional Cross References:**

"Bill of lading". Section 1—201.

"Contract". Section 1—201.

"Genuine". Section 1—201.

**NORTH CAROLINA COMMENT**

This subsection modifies the prior law. There are several specific statutes that are intended to make the proof of specified material simple: GS 8-41, 8-44 and 8-45.1. However, the rule as to business entries is stated as follows: "If the entries were made in the regular course of business, at or near the time of the transaction involved, and are authenticated by a witness who is familiar with them and the system under which they were made,

they are admissible." Stansbury, *The North Carolina Law of Evidence* § 155, at 390 (2d ed. 1963). See *Dairy & Ice Cream Supply Co. v. Gastonia Ice Cream Co.*, 232 N.C. 684, 61 S.E.2d 895 (1950); *Jones v. Atlantic Coast Line R.R.*, 148 N.C. 449, 62 S.E. 521 (1908), where the court held it to be error to use a railroad conductor's record without having him there to authenticate it.

**§ 25-1-203. Obligation of good faith.**—Every contract or duty within this chapter imposes an obligation of good faith in its performance or enforcement. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.  
**Purposes:**

This section sets forth a basic principle running throughout this Act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. Particular applications of this general principle appear in specific provisions of the Act such as the option to accelerate at will (Section 1—208), the right to cure a defective delivery of goods (Section 2—508), the duty of a merchant buyer who has rejected goods to effect salvage operations (Section 2—603), substituted performance (Section 2—614), and failure of presupposed conditions (Section 2—615). The concept, however, is broader than any of these illustrations and applies generally,

as stated in this section, to the performance or enforcement of every contract or duty within this Act. It is further implemented by Section 1—205 on course of dealing and usage of trade.

It is to be noted that under the Sales Article definition of good faith (Section 2—103), contracts made by a merchant have incorporated in them the explicit standard not only of honesty in fact (Section 1—201), but also of observance by the merchant of reasonable commercial standards of fair dealing in the trade.

**Cross references:**

Sections 1—201; 1—205; 1—208; 2—103; 2—508; 2—603; 2—614; 2—615.

**Definitional cross references:**

"Contract". Section 1—201.

"Good faith". Section 1—201; 2—103.

**NORTH CAROLINA COMMENT**

"Good faith" was mentioned in two statutes: GS 27-2 and 55-96 (b). This section

probably makes little substantive change in prior law.

**§ 25-1-204. Time; reasonable time; "seasonably."**—(1) Whenever this chapter requires any action to be taken within a reasonable time, any time which is not manifestly unreasonable may be fixed by agreement.

(2) What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action.

(3) An action is taken "seasonably" when it is taken at or within the time agreed or if no time is agreed at or within a reasonable time. (1899, c. 733, s. 193; Rev., s. 2343; C. S., s. 2978; 1965, c. 700, s. 1.)



**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. Subsection (1) recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertence or overreaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not ob-

viously unfair as judged by the time of contracting.

2. Under the section, the agreement which fixes the time need not be part of the main agreement, but may occur separately. Notice also that under the definition of "agreement" (Section 1-201) the circumstances of the transaction, including course of dealing or usages of trade or course of performance may be material. On the question what is a reasonable time these matters will often be important.

**Definitional cross reference:**

"Agreement". Section 1—201.

**NORTH CAROLINA COMMENT**

See somewhat similar idea in GS 25-3. See discussion in *Raines v. Grantham*, 205 N.C. 340, 171 S.E. 360 (1933). The section

is probably generally in accord with prior law. Subsection (3) is new.

**§ 25-1-205. Course of dealing and usage of trade.**—(1) A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(2) A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court.

(3) A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.

(4) The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.

(5) An applicable usage of trade in the place where any part of performance is to occur shall be used in interpreting the agreement as to that part of the performance.

(6) Evidence of a relevant usage of trade offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise to the latter. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** No such general provision but see Sections 9(1), 15(5), 18(2), and 71, Uniform Sales Act.

**Purposes:** This section makes it clear that:

1. This Act rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circum-

stances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

2. Course of dealing under subsection (1) is restricted, literally to a sequence of conduct between the parties previous to the agreement. However, the provisions of the Act on course of performance make it clear that a sequence of conduct after or under the agreement may have equivalent meaning. (Section 2—208.)

3. "Course of dealing" may enter the

agreement either by explicit provisions of the agreement or by tacit recognition.

4. This Act deals with "usage of trade" as a factor in reaching the commercial meaning of the agreement which the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. By adopting in this context the term "usage of trade" this Act expresses its intent to reject those cases which see evidence of "custom" as representing an effort to displace or negate "established rules of law". A distinction is to be drawn between mandatory rules of law such as the Statute of Frauds provisions of Article 2 on Sales whose very office is to control and restrict the actions of the parties, and which cannot be abrogated by agreement, or by a usage of trade, and those rules of law (such as those in Part 3 of Article 2 on Sales) which fill in points which the parties have not considered and in fact agreed upon. The latter rules hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.

5. A usage of trade under subsection (2) must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial", "universal" or the like. Under the requirement of subsection (2) full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree. There is room also for proper recognition of usage agreed upon by merchants in trade codes.

6. The policy of this Act controlling explicit unconscionable contracts and clauses (Sections 1-203, 2-302) applies to implicit clauses which rest on usage of trade and carries forward the policy underlying the ancient requirement that a custom or usage must be "reasonable". However, the emphasis is shifted. The very fact of commercial acceptance makes out a prima

facie case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable. But the anciently established policing of usage by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.

7. Subsection (3), giving the prescribed effect to usages of which the parties "are or should be aware", reinforces the provision of subsection (2) requiring not universality but only the described "regularity of observance" of the practice or method. This subsection also reinforces the point of subsection (2) that such usages may be either general to trade or particular to a special branch of trade.

8. Although the terms in which this Act defines "agreement" include the elements of course of dealing and usage of trade, the fact that express reference is made in some sections to those elements is not to be construed as carrying a contrary intent or implication elsewhere. Compare Section 1-102(4).

9. In cases of a well established line of usage varying from the general rules of this Act where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled, in any event, to the minimum variation demonstrated. The whole is not to be disregarded because no particular line of detail has been established. In case a dominant pattern has been fairly evidenced, the party relying on the usage is entitled under this section to go to the trier of fact on the question of whether such dominant pattern has been incorporated into the agreement.

10. Subsection (6) is intended to insure that this Act's liberal recognition of the needs of commerce in regard to usage of trade shall not be made into an instrument of abuse.

#### Cross references:

Point 1: Sections 1-203, 2-104 and 2-202.

Point 2: Section 2-208.

Point 4: Section 2-201 and Part 3 of Article 2.

Point 6: Sections 1-203 and 2-302.

Point 8: Sections 1-102 and 1-201.

Point 9: Section 2-204(3).

#### Definitional cross references:

"Agreement". Section 1-201.

"Contract". Section 1-201.

"Party". Section 1-201.

"Term". Section 1-201.

## NORTH CAROLINA COMMENT

The first five subsections are consistent with the common law of contracts in general. Corbin, Contracts § 556, at 244, footnote 86 (1960). See *T. C. May Co. v. Menzies Shoe Co.*, 184 N.C. 150, 113 S.E. 593 (1922), in which the court took cognizance of the fact that "the custom of the trade at that time required of the defendant acceptance or rejection of the orders within eight or ten days . . ." In *McKinney v. Matthews*, 166 N.C. 576, 82 S.E. 1036 (1914), the court said "it was competent to prove the custom and the standard ordinarily prevailing under such contracts . . ."

As to subsections (2) and (3), see *Cohon v. Harrell*, 180 N.C. 39, 103 S.E. 906 (1920), where the court says, "It is the ac-

cepted principle here and elsewhere that a lawful and existent business custom or usage, clearly established, concerning the subject matter of a contract, may be received in evidence to explain ambiguities therein, or to add stipulations about which the contract is silent, and, further, where such a custom is known to the parties, or its existence is so universal and all prevailing that knowledge will be imputed, the parties will be presumed to have contracted in reference to it, unless excluded by the express terms of the agreement between them." Thus, our prior law was generally in accord with subsections (2) and (3).

*Subsection (6):* This subsection seems new.

**§ 25-1-206. Statute of frauds for kinds of personal property not otherwise covered.**—(1) Except in the cases described in subsection (2) of this section a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars (\$5,000.00) in amount or value of remedy unless there is some writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter, and is signed by the party against whom enforcement is sought or by his authorized agent.

(2) Subsection (1) of this section does not apply to contracts for the sale of goods (§ 25-2-201) nor of securities (§ 25-8-319) nor to security agreements (§ 25-9-203). (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29 Charles II).

**Changes:** Completely rewritten by this and other sections.

**Purposes:** To fill the gap left by the Statute of Frauds provisions for goods (Section 2—201), securities (Section 8—319), and security interests (Section 9—203). The Uniform Sales Act covered the sale of "choses in action"; the principal gap relates to sale of the "general intangibles" defined in Article 9 (Section 9—106) and to transactions excluded from Article 9 by Section 9—104. Typical are the sale of bilateral contracts, royalty rights or the like. The informality normal to such transactions is recognized by lifting the limit for oral transactions to \$5,000. In such

transactions there is often no standard of practice by which to judge, and values can rise or drop without warning; troubling abuses are avoided when the dollar limit is exceeded by requiring that the subject-matter be reasonably identified in a signed writing which indicates that a contract for sale has been made at a defined or stated price.

**Definitional cross references:**

"Action". Section 1—201.  
 "Agreement". Section 1—201.  
 "Contract". Section 1—201.  
 "Contract for sale". Section 2—106.  
 "Goods". Section 2—105.  
 "Party". Section 1—201.  
 "Sale". Section 2—106.  
 "Signed". Section 1—201.  
 "Writing". Section 1—201.

## NORTH CAROLINA COMMENT

The general statute of frauds does not apply to personal property. GS 22-1 through 22-4. Therefore, all changes here are a change in the law.

**§ 25-1-207. Performance or acceptance under reservation of rights.**—A party who with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other



party does not thereby prejudice the rights reserved. Such words as "without prejudice," "under protest" or the like are sufficient. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights" and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made "subject to satisfaction of our purchaser," "subject to acceptance by our customers," or the like.

2. This section does not add any new requirement of language of reservation where not already required by law, but merely provides a specific measure on which a party can rely as he makes or

concur in any interim adjustment in the course of performance. It does not affect or impair the provisions of this Act such as those under which the buyer's remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other feels to be unwarranted.

**Cross reference:**

Section 2—607.

**Definitional cross references:**

"Party". Section 1—201.

"Rights". Section 1—201.

### NORTH CAROLINA COMMENT

This seems to be a statement of the prior law. In *Yates v. W. F. Mickey Body Co.*, 258 N.C. 16, 128 S.E.2d 11 (1962), the court says, "The plaintiff knew that defendant required a certain number of catalogs in time for the Miami convention. A thousand catalogs were printed and delivered for that specific purpose.

The defendant, within thirty minutes after they were delivered, informed plaintiff that the page numbers had been omitted and asked him to stop the printing of the others. Under these circumstances, the fact that defendant in an emergency used the 1,000 catalogs would not waive his right to reject the others."

§ 25-1-208. **Option to accelerate at will.**—A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

The increased use of acceleration clauses either in the case of sales on credit or in time paper or in security transactions has led to some confusion in the cases as to the effect to be given to a clause which seemingly grants the power of an acceleration at the whim and caprice of one party. This section is intended to make clear that despite language which can be so construed and which further might be held to make the agreement void as against public policy or to make the contract illusory or too indefinite for enforcement, the clause means that the option is to be exercised

only in the good faith belief that the prospect of payment or performance is impaired.

Obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an agreement or to paper which in the first instance is payable at a future date.

**Definitional cross references:**

"Burden of establishing". Section 1—201.

"Good faith". Section 1—201.

"Party". Section 1—201.

"Term". Section 1—201.

## NORTH CAROLINA COMMENT

The prior law was in accord with part of this section. Such law allowed a note to contain an acceleration provision if collaterals had been deposited provided "the value of the securities so deposited has so decreased or declined as to render the holder insecure . . ." GS 25-10. An acceleration clause in case of failure to pay interest when due did not make the notes nonnegotiable. *Walter v. Kilpatrick*, 191 N.C. 458, 132 S.E. 148 (1926). The part of sentence one concerning an acceleration clause based on a person's ability to accelerate "at will" or "when he deems himself insecure" is new. The last sentence

is similar to prior law. See *C. A. Webb & Co. v. Trustees of Morganton Graded School Dist.*, 143 N.C. 299, 55 S.E. 719 (1906), in which a person agreed to buy municipal bonds provided his attorney found that they were "legally issued." The attorney did not so find. The court says: "It is uniformly held by the courts that, in the absence of any allegation and proof of bad faith or arbitrary conduct on the part of the person selected to pass upon the validity of the bond or performance of the contract on the part of the person seeking its enforcement, his approval is a condition precedent and is essential to the right to demand performance."

## ARTICLE 2.

*Sales.*

## NORTH CAROLINA COMMENT

Some generalizations about the sales article may prove helpful as an introduction before a part by part, section by section, analysis of the Code is undertaken.

The first apparent difference in approach made by the UCC (different from both the Uniform Sales Act and case-law approaches) is that the Code abandons the concept of "title" as the determinant of the rights of parties in a sales contract. See GS 25-2-401. Instead of the title concept, the Code substitutes a "transaction concept" and treats the rights of each party on an issue by issue basis. No preliminary elusive search for "title" is required as was necessary under the Uniform Sales Act and the prior law of North Carolina on sales. Questions as to who has the risk of loss, who may bring an action for price or whose creditors may reach the goods are answered directly by specific rules applicable to specific contracts and conduct of the parties. This is perhaps the most significant departure that the UCC makes from the prior sales law of which practitioners should be made aware.

A statute of frauds relating to the sale of goods will also be a significant addition to the sales law of North Carolina. G.S. 25-2-201 provides that contracts for the sale of goods involving more than \$500 must be in writing. This will be the first statute of frauds relating to personal property to exist in North Carolina since 1792 when the State legislature repealed the seventeenth section of the English statute of frauds, 29 Charles II. The UCC, furthermore, introduces two other new ideas to North Carolina law, the doctrine of part performance and the provision that as between merchants a writing in confirmation of a contract, sufficient as against the sender, will be good as against the recipient as a memorandum of the contract if the recipient fails to object in writing to its contents. This latter innovation also evidences another significant variation in sales law found in the Code; businessmen (called "merchants" in the Code) are held to more business-like standards than nonbusinessmen in certain instances. "Merchants" are held to a higher standard of sophistication than are nonmerchants because they are "professionals."

Another distinctive UCC approach is that sales contracts for the sale of goods should have their own special rules. Rules for the formation of a sales contract are codified in the Code and reliance cannot be placed on general principles of the laws of contracts. The specific rules applicable to sales contracts as set out in the Code govern. For instance, the Code makes the seal obsolete and inoperative as importing consideration for a contract; the Code tends to liberalize and to enforce contracts which may be indefinite to some degree in terms of time for performance, place for delivery, price, or time for payment, by the application of external, objective reasonable standards relied on in the business community or because of prior dealings and trade usages; "firm offers" are made binding and irrevocable, even if made without consideration "between merchants" (see GS 25-2-205). Modifications of contracts may be made without consideration and this rule too is contrary to the common law (GS 25-2-209).

On the subject of "warranties," the Code is generally in accord with prior North

Carolina law. An exception to this is the provision of GS 25-2-317 making warranties, both express and implied, cumulative if consistent. GS 25-2-317 apparently changes the prior North Carolina rule that if there was an express warranty in a sales contract, there could be no coexisting implied warranty on the same subject. In addition, the Code relaxes the requirement of privity in warranty actions by extending warranty coverage to buyers' families, households, and guests who might be injured by reason of a breach of warranty with reference to goods used or consumed. The requirement of privity which disables remote consumers from suing remote sellers or manufacturers for breach of warranty is unchanged.

Another area in which North Carolina's law is materially changed is with respect to goods obtained by a purchaser who gives a "bad check." Under prior law, a purchaser who gave a worthless check for goods got "no" title; he could not pass title to the goods even to a bona fide purchaser. Under the Code (GS 25-2-403), a purchaser who procures goods by passing a "bad check" obtains at least a "voidable" title and can transfer good title to a bona fide purchaser for value at any time before his title is avoided by the seller.

The statute of limitations is changed to four years for all actions arising out of breach of contracts for sales of goods. This, of course, changes the limitation of time within which actions on simple contracts and actions on sealed contracts must be brought, making the statute of limitations uniform as to all sales contracts, thus materially changing North Carolina law in this respect.

## PART 1.

### SHORT TITLE, GENERAL CONSTRUCTION AND SUBJECT MATTER.

§ 25-2-101. **Short title.**—This article shall be known and may be cited as Uniform Commercial Code—Sales. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

This Article is a complete revision and modernization of the Uniform Sales Act which was promulgated by the National Conference of Commissioners on Uniform State Laws in 1906 and has been adopted in 34 states and Alaska, the District of Columbia and Hawaii.

The coverage of the present Article is much more extensive than that of the old Sales Act and extends to the various bodies of case law which have been developed both outside of and under the latter.

The arrangement of the present Article

is in terms of contract for sale and the various steps of its performance. The legal consequences are stated as following directly from the contract and action taken under it without resorting to the idea of when property or title passed or was to pass as being the determining factor. The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character.

#### NORTH CAROLINA COMMENT

This article is entirely new. The Uniform Sales Act, although adopted and in effect in thirty-six states and the Dis-

trict of Columbia, was never adopted in North Carolina.

§ 25-2-102. **Scope; certain security and other transactions excluded from this article.**—Unless the context otherwise requires, this article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

Prior uniform statutory provision: Section 75, Uniform Sales Act.

Changes: Section 75 has been rephrased.

Purposes of changes and new matter: To make it clear that:

The Article leaves substantially unaffected the law relating to purchase money security such as conditional sale or chattel mortgage though it regulates the general sales aspects of such transactions. "Secu-



rity transaction" is used in the same sense as in the Article on Secured Transactions (Article 9).

**Cross reference:**

Article 9.

**Definitional cross references:**

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Present sale". Section 2—106.

"Sale". Section 2—106.

**NORTH CAROLINA COMMENT**

This section sets out the scope of the Code, limiting it to transactions in goods (as defined in GS 25-2-105) and indicates that the article on sales does not apply to transactions intended as security even though in the form of an unconditional

contract of sale or to sell. The section also makes clear that the sales article does not impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

**§ 25-2-103. Definitions and index of definitions.**—(1) In this article unless the context otherwise requires

(a) "Buyer" means a person who buys or contracts to buy goods.

(b) "Good faith" in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

(c) "Receipt" of goods means taking physical possession of them.

(d) "Seller" means a person who sells or contracts to sell goods.

(2) Other definitions applying to this article or to specified parts thereof, and the sections in which they appear are:

"Acceptance." § 25-2-606.

"Banker's credit." § 25-2-325.

"Between merchants." § 25-2-104.

"Cancellation." § 25-2-106 (4).

"Commercial unit." § 25-2-105.

"Confirmed credit." § 25-2-325.

"Conforming to contract." § 25-2-106.

"Contract for sale." § 25-2-106.

"Cover." § 25-2-712.

"Entrusting." § 25-2-403.

"Financing agency." § 25-2-104.

"Future goods." § 25-2-105.

"Goods." § 25-2-105.

"Identification." § 25-2-501.

"Installment contract." § 25-2-612.

"Letter of credit." § 25-2-325.

"Lot." § 25-2-105.

"Merchant." § 25-2-104.

"Overseas." § 25-2-323.

"Person in position of seller." § 25-2-707.

"Present sale." § 25-2-106.

"Sale." § 25-2-106.

"Sale on approval." § 25-2-326.

"Sale or return." § 25-2-326.

"Termination." § 25-2-106.

(3) The following definitions in other articles apply to this article:

"Check." § 25-3-104.

"Consignee." § 25-7-102.

"Consignor." § 25-7-102.

"Consumer goods." § 25-9-109.

"Dishonor." § 25-3-507.

"Draft." § 25-3-104.

(4) In addition article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sub-section (1): Section 76, Uniform Sales Act.

**Changes:**

The definitions of "buyer" and "seller" have been slightly rephrased, the reference in Section 76 of the prior Act to "any legal successor in interest of such person" being omitted. The definition of "receipt" is new.

**Purposes of changes and new matter:**

1. The phrase "any legal successor in interest of such person" has been eliminated since Section 2—210 of this Article, which limits some types of delegation of performance on assignment of a sales contract, makes it clear that not every such successor can be safely included in the definition. In every ordinary case, however, such successors are as of course included.

2. "Receipt" must be distinguished from delivery particularly in regard to the problems arising out of shipment of goods, whether or not the contract calls for making delivery by way of documents of title, since the seller may frequently fulfill his obligations to "deliver" even though the buyer may never "receive" the goods. Delivery with respect to documents of title is defined in Article 1 and requires transfer of physical delivery. Otherwise the many divergent incidents of delivery are handled incident by incident.

**Cross references:**

Point 1: See Section 2—210 and Comment thereon.

Point 2: Section 1—201.

**Definitional cross reference:**

"Person". Section 1—201.

## NORTH CAROLINA COMMENT

There appears to be no specific change in prior North Carolina law attributable to this section. There were, however, no statutes related to this section and the cases do not expressly define the terms

treated here. They are expressly and explicitly defined in the Code because of the UCC's general concern for the precise use of language in cross references.

**§ 25-2-104. Definitions: "Merchant"; "between merchants"; "financing agency."**—(1) "Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

(2) "Financing agency" means a bank, finance company or other person who in the ordinary course of business makes advances against goods or documents of title or who by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale, as by purchasing or paying the seller's draft or making advances against it or by merely taking it for collection whether or not documents of title accompany the draft. "Financing agency" includes also a bank or other person who similarly intervenes between persons who are in the position of seller and buyer in respect to the goods (§ 25-2-707).

(3) "Between merchants" means in any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None. But see Sections 15 (2), (5), 16(c), 45(2) and 71, Uniform Sales Act, and Sections 35 and 37, Uniform Bills of Lading Act for examples of the policy expressly provided for in this Article.

**Purposes:**

1. This Article assumes that transaction between professionals in a given field require special and clear rules which may not apply to a casual or inexperienced seller or buyer. It thus adopts a policy of

expressly stating rules applicable "between merchants" and "as against a merchant" wherever they are needed instead of making them depend upon the circumstances of each case as in the statutes cited above. This section lays the foundation of this policy by defining those who are to be regarded as professionals or "merchants" and by stating when a transaction is deemed to be "between merchants".

2. The term "merchant" as defined here roots in the "law merchant" concept of a

professional in business. The professional status under the definition may be based upon specialized knowledge as to the goods, specialized knowledge as to business practices, or specialized knowledge as to both and which kind of specialized knowledge may be sufficient to establish the merchant status is indicated by the nature of the provisions.

The special provisions as to merchants appear only in this Article and they are of three kinds. Sections 2—201(2), 2—205, 2—207 and 2—209 dealing with the statute of frauds, firm offers, confirmatory memoranda and modification rest on normal business practices which are or ought to be typical of and familiar to any person in business. For purposes of these sections almost every person in business would, therefore, be deemed to be a “merchant” under the language “who . . . by his occupation holds himself out as having knowledge or skill peculiar to the practices . . . involved in the transaction . . .” since the practices involved in the transaction are non-specialized business practices such as answering mail. In this type of provision, banks or even universities, for example, well may be “merchants.” But even these sections only apply to a merchant in his mercantile capacity; a lawyer or bank president buying fishing tackle for his own use is not a merchant.

On the other hand, in Section 2—314 on the warranty of merchantability, such warranty is implied only “if the seller is a merchant with respect to goods of that kind.” Obviously this qualification restricts the implied warranty to a much smaller group than everyone who is engaged in business and requires a professional status as to particular kinds of goods. The exception in Section 2—402(2) for retention

of possession by a merchant-seller falls in the same class; as does Section 2—403(2) on entrusting of possession to a merchant “who deals in goods of that kind”.

A third group of sections includes 2—103(1) (b), which provides that in the case of a merchant “good faith” includes observance of reasonable commercial standards of fair dealing in the trade; 2—327(1) (c), 2—603 and 2—605, dealing with responsibilities of merchant buyers to follow seller’s instructions, etc.; 2—509 on risk of loss, and 2—609 on adequate assurance of performance. This group of sections applies to persons who are merchants under either the “practices” or the “goods” aspect of the definition of merchant.

3. The “or to whom such knowledge or skill may be attributed by his employment of an agent or broker . . .” clause of the definition of merchant means that even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel who are familiar with business practices and who are equipped to take any action required.

#### Cross references:

Point 1: See Sections 1—102 and 1—203.

Point 2: See Sections 2—314, 2—315 and 2—320 to 2—325, of this Article, and Article 9.

#### Definitional cross references:

“Bank”. Section 1—201.

“Buyer”. Section 2—103.

“Contract for sale”. Section 2—106.

“Document of title”. Section 1—201.

“Draft”. Section 3—104.

“Goods”. Section 2—105.

“Person”. Section 1—201.

“Purchase”. Section 1—201.

“Seller”. Section 2—103.

### NORTH CAROLINA COMMENT

*Subsections (1) and (3):* One of the unique features of the sales article of the Code finds its genesis in this section. At various points in the Code different standards are applied to “merchants” as opposed to “nonmerchant” buyers and sellers. (See, e.g., *inter alia*, GS 25-2-201, which provides a special exception to the statute of frauds applicable only to “merchants” wherein a merchant is held liable in contract of sale or to sell upon his receipt of a memorandum and his failure to object to its terms. Also note that GS 25-2-205, which relates to firm offers made without consideration, applies only to “merchants.” GS 25-2-207 sets out special provisions as to the effect of the inclusion

of additional or different terms to a contract in an acceptance “between merchants.” GS 25-2-209 (2) establishes special rules as to limitations or modifications of contracts between “merchants” and “nonmerchants.” See also GS 25-2-603, imposing special duties on a “merchant buyer” who has rightfully rejected goods sent by seller, and GS 25-2-605 (1) (b), where merchant seller may request written specification of defects upon which a rejection is based if the buyer is also a merchant. See also GS 25-2-314, relating to the implied warranty of merchantability which under the UCC applies only when the sale is by a seller who is a “merchant.”)



The distinctions between "merchants" and "nonmerchants" and as to contracts "between merchants" are new to North Carolina law and result in significant differences of treatment resulting in significant changes in North Carolina law in

distinguishing legal relations created between those who are essentially "professionals" and those who are not.

*Subsection (2)*, defining "financing agency," is new in North Carolina law.

**§ 25-2-105. Definitions: Transferability; "goods"; "future" goods; "lot"; "commercial unit."**—(1) "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (article 8) and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (§ 25-2-107).

(2) Goods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are "future" goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(3) There may be a sale of a part interest in existing identified goods.

(4) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

(5) "Lot" means a parcel or a single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract.

(6) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine) or a set of articles (as a suite of furniture or an assortment of sizes) or a quantity (as a bale, gross, or carload) or any other unit treated in use or in the relevant market as a single whole. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Subsections (1), (2), (3) and (4)—Sections 5, 6 and 76, Uniform Sales Act; Subsections (5) and (6)—none.

**Changes:** Rewritten.

**Purposes of changes and new matter:**

1. Subsection (1) on "goods": The phraseology of the prior uniform statutory provision has been changed so that:

The definition of goods is based on the concept of movability and the term "chattels personal" is not used. It is not intended to deal with things which are not fairly identifiable as movables before the contract is performed.

Growing crops are included within the definition of goods since they are frequently intended for sale. The concept of "industrial" growing crops has been abandoned, for under modern practices fruit, perennial hay, nursery stock and the like must be brought within the scope of this Article. The young of animals are also included expressly in this definition since they, too, are frequently intended for sale

and may be contracted for before birth. The period of gestation of domestic animals is such that the provisions of the section on identification can apply as in the case of crops to be planted. The reason of this definition also leads to the inclusion of a wool crop or the like as "goods" subject to identification under this Article.

The exclusion of "money in which the price is to be paid" from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject matter of a sales transaction. Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment.

As to contracts to sell timber, minerals, or structures to be removed from the land Section 2—107(1) (Goods to be severed from realty: recording) controls.

The use of the word "fixtures" is avoided in view of the diversity of definitions of that term. This Article in includ-

ing within its scope "things attached to realty" adds the further test that they must be capable of severance without material harm thereto. As between the parties any identified things which fall within that definition become "goods" upon the making of the contract for sale.

"Investment securities" are expressly excluded from the coverage of this Article. It is not intended by this exclusion, however, to prevent the application of a particular section of this Article by analogy to securities (as was done with the Original Sales Act in *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479, 99 A.L.R. 269 (1934)) when the reason of that section makes such application sensible and the situation involved is not covered by the Article of this Act dealing specifically with such securities (Article 8).

2. References to the fact that a contract for sale can extend to future or contingent goods and that ownership in common follows the sale of a part interest have been omitted here as obvious without need for expression; hence no inference to negate these principles should be drawn from their omission.

3. Subsection (4) does not touch the question of how far an appropriation of a bulk of fungible goods may or may not satisfy the contract for sale.

4. Subsections (5) and (6) on "lot" and "commercial unit" are introduced to aid in the phrasing of later sections.

5. The question of when an identification of goods takes place is determined by the provisions of Section 2-501 and all that this section says is what kinds of goods may be the subject of a sale.

#### Cross references:

Point 1: Sections 2-107, 2-201, 2-501 and Article 8.

Point 5: Section 2-501.

See also Section 1-201.

#### Definitional cross references:

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Fungible". Section 1-201.

"Money". Section 1-201.

"Present sale". Section 2-106.

"Sale". Section 2-106.

"Seller". Section 2-103.

### NORTH CAROLINA COMMENT

*Subsection (1)*, defining "goods," accords with North Carolina cases. See *Vaughan v. Town of Murfreesboro*, 96 N.C. 317, 2 S.E. 676 (1887); *Pippin v. Ellison*, 34 N.C. 61 (1851), distinguishing "goods" from choses in action but making the term embrace not only tangible inanimate property such as furniture, farming utensils, corn, etc., but also slaves, horses, cattle, hogs, etc. Growing crops can also be dealt with as personality. See *Odum v. Clark*, 146 N.C. 544, 60 S.E. 513 (1908). Unborn animals are likewise the subject of sales as "goods." See *Fonville v. Casey*, 5 N.C. 389 (1810).

*Subsection (2)* accords with *DeVane v. Fennell*, 24 N.C. 36 (1841), and *Heiser v. Mears*, 120 N.C. 443, 27 S.E. 117 (1897), that no interest passes in goods until in existence and identified, and pending their existence or identification, a contract re-

lating to their sale is only a contract "to sell."

*Subsection (3)* accords with prior North Carolina law that there may be a sale of a part interest in an identified chattel. See *Bullman v. Edney*, 232 N.C. 465, 61 S.E.2d 338 (1950), creating a tenancy in common in personality.

*Subsection (4)* changes the law in North Carolina. See the case of *Waldo v. Belcher*, 33 N.C. 609 (1850), which held that a sale of 2800 of 3100 bushels of stored corn did not pass title because not sufficiently identified to the contract. The UCC provision accords with § 6 (1) of the Uniform Sales Act and follows what it known as the "American Rule" as to the sale of fungible goods.

*Subsections (5) and (6)* have no statutory or decisional parallel in North Carolina law.

**§ 25-2-106. Definitions: "Contract"; "agreement"; "contract for sale"; "sale"; "present sale"; "conforming" to contract; "termination"; "cancellation."**—(1) In this article unless the context otherwise requires "contract" and "agreement" are limited to those relating to the present or future sale of goods. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (§ 25-2-401). A "present sale" means a sale which is

(2) Goods or conduct including any part of a performance are "conforming" or accomplished by the making of the contract.

conform to the contract when they are in accordance with the obligations under the contract.

(3) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination" all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains remedy any breach [any remedy for breach] of the whole contract or any unperformed balance. (1965, c. 700, s. 1.)

**Editor's Note.**—The language in brackets in subsection (4) is suggested as a correction of "remedy any breach," which appears in the 1965 Session Laws.

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Subsection (1)—Section 1 (1) and (2), Uniform Sales Act; Subsection (2)—none, but subsection generally continues policy of Sections 11, 44 and 69, Uniform Sales Act; Subsections (3) and (4)—none.

**Changes:** Completely rewritten.

**Purposes of changes and new matter:**

1. Subsection (1): "Contract for sale" is used as a general concept throughout this Article, but the rights of the parties do not vary according to whether the transaction is a present sale or a contract to sell unless the Article expressly so provides.

2. Subsection (2): It is in general intended to continue the policy of requiring exact performance by the seller of his obligations as a condition to his right to require acceptance. However, the seller is in part safeguarded against surprise as a result of sudden technicality on the buyer's part by the provisions of Section 2-508 on seller's cure of improper tender or de-

livery. Moreover usage of trade frequently permits commercial leeways in performance and the language of the agreement itself must be read in the light of such custom or usage and also, prior course of dealing, and in a long term contract, the course of performance.

3. Subsections (3) and (4): These subsections are intended to make clear the distinction carried forward throughout this Article between termination and cancellation.

#### Cross references:

Point 2: Sections 1-203, 1-205, 2-208 and 2-508.

#### Definitional cross references:

"Agreement". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Party". Section 1-201.

"Remedy". Section 1-201.

"Rights". Section 1-201.

"Seller". Section 2-103.

### NORTH CAROLINA COMMENT

No significant change in North Carolina law is perceived as a result of this section which serves mainly to fill out the

general aims of the Code to provide a self-sufficient statement of the law of sales.

**§ 25-2-107. Goods to be severed from realty; recording.**—(1) A contract for the sale of timber, minerals or the like or a structure or its materials to be removed from realty is a contract for the sale of goods within this article if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) is a contract for the sale of goods within this article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute



notice to third parties of the buyer's rights under the contract for sale. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** See Section 76, Uniform Sales Act on prior policy; Section 7, Uniform Conditional Sales Act.

#### Purposes:

1. Subsection (1). Notice that this subsection applies only if the timber, minerals or structures "are to be severed by the seller". If the buyer is to sever, such transactions are considered contracts affecting land and all problems of the Statute of Frauds and of the recording of land rights apply to them. Therefore, the Statute of Frauds section of this Article does not apply to such contracts though they must conform to the Statute of Frauds affecting the transfer of interests in land.

2. Subsection (2). "Things attached" to the realty which can be severed without material harm are goods within this Article regardless of who is to effect the severance. The word "fixtures" has been avoided because of the diverse definitions of this term, the test of "severance without material harm" being substituted.

The provision in subsection (3) for recording such contracts is within the purview of this Article since it is a means of preserving the buyer's rights under the contract of sale.

3. The security phases of things attached to or to become attached to realty are dealt with in the Article on Secured Transactions (Article 9) and it is to be noted that the definition of goods in that Article differs from the definition of goods in this Article.

#### Cross references:

Point 1: Section 2—201.

Point 2: Section 2—105.

Point 3: Articles 9 and 9—105.

#### Definitional cross references:

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Goods". Section 2—105.

"Party". Section 1—201.

"Present sale". Section 2—106.

"Rights". Section 1—201.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

*Subsection (1)* accords with prior North Carolina law that if a seller is to sever articles from the realty pursuant to a contract of sale, the contract is for a sale of personalty. See *Walston v. Lowry*, 212 N.C. 23, 192 S.E. 877 (1937), where it is held that a contract whereby the seller contracts to sell timber, to be cut by the seller, is a contract to sell personalty and not a contract to sell realty requiring a writing. In addition, North Carolina went further than this UCC subsection and held that even if the contract specifies that the buyer is to make the severance of articles attached to the realty from the seller's land, such is a contract for the sale of personalty and not a contract for the sale of realty and need not be in writing as required under the statute of frauds relating to contracts for the sale of realty (GS 22-2). See *Bishop v. DuBose*, 252 N.C. 158, 113 S.E.2d 309 (1960). If the contract does not contemplate the passage of title until after severance, it is a contract for the sale of personalty irrespective of who is to make the severance. *Johnson v. Wallin*, 227 N.C. 669, 44 S.E.2d 83 (1947); *Ives v. Atlantic & N.C.R.R.*, 142 N.C. 131, 55 S.E. 74 (1906).

*Subsection (2)* accords in principle with *Flynt v. Conrad*, 61 N.C. 190 (1867), that

a growing crop is a personal chattel and can be transferred or reserved by parol contract because it is personalty. Other items affixed to real property which can be removed without injury to the realty are treated as goods by this subsection of the UCC even though attached at the time the contract is made and without regard to which party (buyer or seller) is to make the severance. This latter aspect of subsection (2) would appear to conflict with prior North Carolina law that if an item is affixed to the land, it is presumed to be a part of the realty to which attached and in order to create a binding contract to sell such item, there must be a writing as required for contracts for the sale of realty. See *Stephens v. Carter*, 246 N.C. 318, 98 S.E.2d 311 (1957).

Whether an item is to be deemed "real" or "personal" property ("goods") will be determined under the Code by its potential for severability without injury to the realty to which it is attached and not upon the more difficult determination of whether the item is a "fixture."

It is interesting to note that in North Carolina the net effect of subsections (1) and (2) will be that while certain contracts will be rendered "sales of goods" that were considered "sales of realty" (see

Stephens v. Carter, 246 N.C. 318, 98 S.E.2d 311 (1957) ), with the adoption of the UCC, GS 25-2-201, establishing a statute of frauds for the sale of goods for more than \$500, more contracts will have to be in writing notwithstanding that many contracts formerly held to be sales of realty shall have become sales of "goods."

Subsection (3) provides for recording a contract contemplating severance of items

attached to realty, such recordation to be upon the real property recordation books, whether or not there will be material injury to the realty. This provision is new to North Carolina law and serves to preserve the rights of a buyer of an item attached to realty (which is to be severed) from the claims of purchasers of the realty and lien creditors of the owner-seller.

## PART 2.

### FORM, FORMATION AND READJUSTMENT OF CONTRACT.

§ 25-2-201. **Formal requirements; statute of frauds.**—(1) Except as otherwise provided in this section a contract for the sale of goods for the price of five hundred dollars (\$500.00) or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(2) Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within ten days after it is received.

(3) A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable

(a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or

(b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods for which payment has been made and accepted or which have been received and accepted (§ 25-2-606). (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29 Charles II).

**Changes:** Completely re-phrased; restricted to sale of goods. See also Sections 1—206, 8—319 and 9—203.

**Purposes of changes.** The changed phraseology of this section is intended to make it clear that:

1. The required writing need not contain all the material terms of the contract and such material terms as are stated need not be precisely stated. All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real transaction. It may be

written in lead pencil on a scratch pad. It need not indicate which party is the buyer and which the seller. The only term which must appear is the quantity term which need not be accurately stated but recovery is limited to the amount stated. The price, time and place of payment or delivery, the general quality of the goods, or any particular warranties may all be omitted.

Special emphasis must be placed on the permissibility of omitting the price term in view of the insistence of some courts on the express inclusion of this term even where the parties have contracted on the basis of a published price list. In many valid contracts for sale the parties do not mention the price in express terms, the

buyer being bound to pay and the seller to accept a reasonable price which the trier of the fact may well be trusted to determine. Again, frequently the price is not mentioned since the parties have based their agreement on a price list or catalogue known to both of them and this list serves as an efficient safeguard against perjury. Finally, "market" prices and valuations that are current in the vicinity constitute a similar check. Thus if the price is not stated in the memorandum it can normally be supplied without danger of fraud. Of course if the "price" consists of goods rather than money the quantity of goods must be stated.

Only three definite and invariable requirements as to the memorandum are made by this subsection. First, it must evidence a contract for the sale of goods; second, it must be "signed", a word which includes any authentication which identifies the party to be charged; and third, it must specify a quantity.

2. "Partial performance" as a substitute for the required memorandum can validate the contract only for the goods which have been accepted or for which payment has been made and accepted

Receipt and acceptance either of goods or of the price constitutes an unambiguous overt admission by both parties that a contract actually exists. If the court can make a just apportionment therefor, the agreed price of any goods actually delivered can be recovered without a writing or, if the price has been paid, the seller can be forced to deliver an apportionable part of the goods. The overt actions of the parties make admissible evidence of the other terms of the contract necessary to a just apportionment. This is true even though the actions of the parties are not in themselves inconsistent with a different transaction such as a consignment for resale or a mere loan of money.

Part performance by the buyer requires the delivery of something by him that is accepted by the seller as such performance. Thus, part payment may be made by money or check, accepted by the seller. If the agreed price consists of goods or services, then they must also have been delivered and accepted.

3. Between merchants, failure to answer a written confirmation of a contract within ten days of receipt is tantamount to a writing under subsection (2) and is sufficient against both parties under subsection (1). The only effect, however, is to take away from the party who fails to answer

the defense of the Statute of Frauds; the burden of persuading the trier of fact that a contract was in fact made orally prior to the written confirmation is unaffected. Compare the effect of a failure to reply under Section 2-207.

4. Failure to satisfy the requirements of this section does not render the contract void for all purposes, but merely prevents it from being judicially enforced in favor of a party to the contract. For example, a buyer who takes possession of goods as provided in an oral contract which the seller has not meanwhile repudiated, is not a trespasser. Nor would the Statute of Frauds provisions of this section be a defense to a third person who wrongfully induces a party to refuse to perform an oral contract, even though the injured party cannot maintain an action for damages against the party so refusing to perform.

5. The requirement of "signing" is discussed in the comment to Section 1-201.

6. It is not necessary that the writing be delivered to anybody. It need not be signed or authenticated by both parties but it is, of course, not sufficient against one who has not signed it. Prior to a dispute no one can determine which party's signing of the memorandum may be necessary but from the time of contracting each party should be aware that to him it is signing by the other which is important.

7. If the making of a contract is admitted in court, either in a written pleading, by stipulation or by oral statement before the court, no additional writing is necessary for protection against fraud. Under this section it is no longer possible to admit the contract in court and still treat the Statute as a defense. However, the contract is not thus conclusively established. The admission so made by a party is itself evidential against him of the truth of the facts so admitted and of nothing more; as against the other party, it is not evidential at all.

#### Cross references:

See Sections 1-201, 2-202, 2-207, 2-209 and 2-304.

#### Definitional cross references:

"Action". Section 1-201.

"Between merchants". Section 2-104.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Notice". Section 1-201.



"Party". Section 1—201.

"Reasonable time". Section 1—204.

"Sale". Section 2—106.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

The statute of frauds relating to the sale of goods, while at one time in effect in North Carolina, has not been in force in this State since 1792. See *Odom v. Clark*, 146 N.C. 544, 60 S.E. 513 (1908). This entire section is new to the law of North Carolina.

North Carolina, however, does have the statute of frauds as it relates to real property transactions. The statute of frauds provision of the UCC, therefore, will be considered in the context of North Carolina's current decisions relating to the statute of frauds:

The second sentence of subsection (1) of GS 25-2-201 provides that a writing is not insufficient to satisfy the statute of frauds because it omits or incorrectly states a term; but that a contract is not enforceable beyond the quantity of goods shown in writing if terms are omitted in the contract. North Carolina law provides in the statute of frauds cases that a memorandum of contract to satisfy the statute must embody the terms of the contract, the names of the vendor and vendee, a description of the property to be transferred and that it should be signed by the party to be charged therewith or by someone lawfully authorized by the party to be charged. The essential terms of the contract, the price and a description of the property to be transferred must be in the contract. See *Harvey v. Linker*, 226 N.C. 711, 40 S.E.2d 202 (1946); *Hall v. Misenheimer*, 137 N.C. 183, 49 S.E. 104 (1904); *Shepherd v. Duke Power Co.*, 140 F. Supp. 27 (M.D.N.C. 1926). But see, even in North Carolina, the cases of *Bateman v. Hopkins*, 157 N.C. 470, 73 S.E. 133 (1911), and *Mizell v. Burnett*, 49 N.C. 249 (1857), which hold that if the action is against the *vendor* on a contract to sell land, it is not required for the validity of the contract that the consideration appear in the writing and parol evidence is admissible to show the purchase price.

This UCC provision, while requiring a memorandum and while requiring application of the statute of frauds to sales of personalty, lessens the rigid requirements of the statute of frauds in effect in North Carolina as now applied to realty, which requires that every essential term of a contract must be in the memorandum before it will be enforced. A memorandum that will satisfy the statute of frauds requirement under this section need only

(1) contain a writing sufficient to indicate a contract of sale between the parties; (2) be signed by the parties or by authorized agents; and (3) state a quantity. The quantity term is the "heart" of the contract. The other terms such as price (GS 25-2-305), place of delivery (GS 25-2-308) and time of delivery (GS 25-2-309) will be supplied by this article if omitted in the memorandum of contract. In addition, these terms can apparently be supplied by parol. Prior North Carolina law applicable to the statute of frauds will be materially changed.

*Subsection (2)* is entirely new and has no parallel in prior North Carolina law. Note that subsection (2) applies "between merchants" only.

*Subsection (3) (a)* recognizes the doctrine of part performance as taking a contract out of the statute of frauds provision. North Carolina did not recognize that partial performance would take a contract otherwise required to be in writing outside of the statute of frauds. *Hall v. Misenheimer*, 137 N.C. 183, 49 S.E. 104 (1904); *Ebert v. Disher*, 216 N.C. 36, 3 S.E.2d 301 (1939); *Grantham v. Grant-ham*, 205 N.C. 363, 171 S.E. 331 (1933).

Since North Carolina did not have a statute of frauds as to contracts for the sale of personal property, the same results as were reached will be reached under this UCC provision, subsection (3) (a), requiring a writing but obviating the necessity for a writing where partial performance as set out in subsection (3) (a) is present.

*Subsection (3) (b)* accords with *Sandlin v. Kearney*, 154 N.C. 596, 70 S.E. 942 (1911), that the admissions of the parties in their pleadings may stand for the writing required by the statute of frauds.

*Subsection (3) (c)* would seem to accord with prior North Carolina law that the statute of frauds applies only to executory contracts and not to executed contracts. See *Sprinkle v. Ponder*, 233 N.C. 312, 64 S.E.2d 171 (1951); *Willis v. Willis*, 242 N.C. 597, 89 S.E.2d 152 (1955); *Keith Bros. v. Kennedy*, 194 N.C. 784, 140 S.E. 721 (1927). But note that this UCC section makes the contract enforceable only with respect to goods for which payment has been made and accepted or which have been received and accepted in the absence of a writing.

**§ 25-2-202. Final written expression; parol or extrinsic evidence.—**

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of dealing or usage of trade (§ 25-1-205) or by course of performance (§ 25-2-208); and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. This section definitely rejects:

(a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;

(b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and

(c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was

phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

3. Under paragraph (b) consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.

**Cross references:**

Point 3: Sections 1—205, 2—207, 2—302 and 2—316.

**Definitional cross references:**

“Agreed” and “agreement”. Section 1—201.

“Course of dealing”. Section 1—205.

“Parties”. Section 1—201.

“Terms”. Section 1—201.

“Usage of trade”. Section 1—205.

“Written” and “writing”. Section 1—201.

**NORTH CAROLINA COMMENT**

The purpose of paragraph (a) is to relax the application of the parol evidence rule to written contracts involving the sale of goods. North Carolina has held that where a contract is unambiguous, parol evidence to explain what the contract is, or to add to or vary it, is inadmissible. See *Bost v. Bost*, 234 N.C. 554, 67 S.E.2d 745 (1951); *Pierce v. Cobb*, 161 N.C. 300, 77 S.E. 350 (1913). If, on the other hand, terms of uncertain meaning are employed, parol evidence may be admitted to show their meaning in a technical or trade sense. See *Layton v. Elba Mfg. Co.*, 161 N.C. 482, 77 S.E. 677 (1913), where the contract term “car load” was amplified and explained by pa-

rol according to custom and usage in a particular business and trade. See also *Neal v. Camden Ferry Co.*, 166 N.C. 563, 82 S.E. 878 (1914).

This UCC provision will allow admission of “course of dealing or usage of trade” evidence even in the absence of ambiguity, thus apparently changing prior North Carolina law. Compare *Williamson v. Miller*, 231 N.C. 722, 58 S.E.2d 743 (1950). This section would not limit, apparently, parol evidence to an explanation of a term of the written contract.

Paragraph (b) apparently continues prior North Carolina law that when a writing is not complete, consistent additional terms agreed to in parol may be ad-

mitted to supply terms on which the writing is silent. See *Willis v. Jarrett Constr. Co.*, 152 N.C. 100, 67 S.E. 265 (1910). The UCC provision says, however, that if the court finds the writing to have been intended as a complete and exclusive statement of the terms of the agreement, evidence of consistent additional terms shall not be added.

The UCC provision seems to indicate a presumption that the written memorandum does not necessarily include all the final terms of the contract—that additional terms may be shown unless the memorandum not only evidences a sale but also that it is in fact the “final and exclusive” statement of terms.

Prior North Carolina law, on the other hand, apparently presumed that a written

contract embraces all previous stipulations between the parties and places the burden of showing any ambiguity or omission, or that the writing does not contain all of the terms of the contract upon the party seeking to add to or explain the writing, however consistent the addition may be. See *Reynolds v. Palmer*, 21 Fed. 433 (W.D.N.C. 1884); *Walker v. Horne*, 149 F. Supp. 457 (W.D.N.C. 1957); *Neal v. Marrone*, 239 N.C. 73, 79 S.E.2d 239 (1953).

While the change will not be radical, the parol evidence rule will be liberalized somewhat by this section of the UCC in the absence of an express stipulation that the contract contains the complete and exclusive terms of the contract.

**§ 25-2-203. Seals inoperative.**—The affixing of a seal to a writing evidencing a contract for sale or an offer to buy or sell goods does not constitute the writing a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 3. Uniform Sales Act.

**Changes:** Portion pertaining to “seals” rewritten.

##### Purposes of changes:

1. This section makes it clear that every effect of the seal which relates to “sealed instruments” as such is wiped out insofar as contracts for sale are concerned. However, the substantial effects of a seal, except extension of the period of limitations, may be had by appropriate drafting as in the case of firm offers (see Section 2—205).

2. This section leaves untouched any aspects of a seal which relate merely to signatures or to authentication of execution and the like. Thus, a statute providing that

a purported signature gives prima facie evidence of its own authenticity or that a signature gives prima facie evidence of consideration is still applicable to sales transactions even though a seal may be held to be a signature within the meaning of such a statute. Similarly, the authorized affixing of a corporate seal bearing the corporate name to a contractual writing purporting to be made by the corporation may have effect as a signature without any reference to the law of sealed instruments.

##### Cross reference:

Point 1: Section 2—205.

##### Definitional cross references:

“Contract for sale”. Section 2—106.

“Goods”. Section 2—105.

“Writing”. Section 1—201.

#### NORTH CAROLINA COMMENT

North Carolina has recognized the effect of a seal; if a contract is under seal it obviates requirement of showing any consideration. See *Angier v. Howard*, 94 N.C. 27 (1886); *Basketeria Stores v. Public Indem. Co.*, 204 N.C. 537, 168 S.E. 822 (1933). The seal imports consideration. See *Thomason v. Bescher*, 176 N.C. 622, 97 S.E. 654 (1918); *Harrell v. Watson*, 63 N.C. 454 (1869); *Mordecai's Law Lectures* 1053-4; *Coleman v. Whisnant*, 226 N.C. 258, 37 S.E.2d 693 (1946); *McGowan v. Beach*, 242 N.C. 73, 86 S.E.2d 763 (1955).

This UCC provision makes the prior law of seals inapplicable to sales contracts in North Carolina and therefore changes North Carolina law. All sealed contracts become simple contracts, requiring other consideration to be shown and resulting in a shorter statute of limitations. See GS 25-2-725. Contracts that were enforceable in North Carolina are not enforceable under this UCC provision.

**§ 25-2-204. Formation in general.**—(1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.



(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 1 and 3, Uniform Sales Act.

**Changes:** Completely rewritten by this and other sections of this Article.

**Purposes of changes:**

Subsection (1) continues without change the basic policy of recognizing any manner of expression of agreement, oral, written or otherwise. The legal effect of such an agreement is, of course, qualified by other provisions of this Article.

Under subsection (1) appropriate conduct by the parties may be sufficient to establish an agreement. Subsection (2) is directed primarily to the situation where the interchanged correspondence does not disclose the exact point at which the deal was closed, but the actions of the parties indicate that a binding obligation has been undertaken.

Subsection (3) states the principle as to "open terms" underlying later sections of the Article. If the parties intend to enter into a binding agreement, this subsection recognizes that agreement as valid in law, despite missing terms, if there is any reasonably certain basis for granting a remedy. The test is not certainty as to what the parties were to do nor as to the exact amount of damages due the plaintiff.

Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of "indefiniteness" are intended to be applied, this Act making provision elsewhere for missing terms needed for performance, open price, remedies and the like.

The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement, but their actions may be frequently conclusive on the matter despite the omissions.

**Cross references:**

Subsection (1): Sections 1—103, 2—201 and 2—302.

Subsection (2): Sections 2—205 through 2—209.

Subsection (3): See Part 3.

**Definitional cross references:**

"Agreement". Section 1—201.

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Goods". Section 2—105.

"Party". Section 1—201.

"Remedy". Section 1—201.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1)* accords generally with prior North Carolina law. See *Crook v. Cowan*, 64 N.C. 743 (1870), and *T. C. May Co. v. Menzies Shoe Co.*, 186 N.C. 144, 119 S.E. 227 (1923), that conduct of the parties may indicate the intention of the parties that a contract exists. This provision is inserted primarily to insure a liberal approach to finding the existence of a contract where the sale of goods is concerned because of a belief that commercial practices often recognize very informal dealings as creating binding obligations.

*Subsection (2)* has no counterpart in prior North Carolina statutory or decisional law.

*Subsection (3)* would seem to change North Carolina law to some extent. It was a recognized general principle in North Carolina law that parties to a contract had to assent to the same thing in the same sense, and their minds had to meet as to

all terms and if any portion of proposed terms was not settled, or no mode was agreed on by which they might be settled, there was no agreement. *Kirby v. Stokes County Bd. of Educ.*, 230 N.C. 619, 55 S.E.2d 322 (1949); *Goeckel v. Stokely*, 236 N.C. 604, 73 S.E.2d 618 (1952). But in other instances the North Carolina court retreated from this principle and enforced "output" and "requirements" contracts. See *Herren v. Gaines*, 63 N.C. 72 (1868); *Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co.*, 134 N.C. 574, 47 S.E. 116 (1904). The court has supplied a "place of delivery" term when the contract was silent. See *Fruit Growers' Express Co. v. Plate Ice Co.*, 59 F.2d 605 (4th Cir. 1935). The court has supplied "time for performance" terms where omitted in a contract otherwise sufficient. See *Hurlburt v. Simpson*, 25 N.C. 233 (1842); *J. B. Colt Co. v. Kimball*, 190 N.C. 169, 129 S.E. 406 (1925). See North Carolina Comments under GS

25-2-305, 25-2-306, 25-2-308, 25-2-309, which are related to this section.

In appropriate cases where the parties intend to be bound but omit certain terms from their contract, subsection (3) will substitute external, objective commercial

standards in lieu of having the contract declared void for indefiniteness because of the lack of a statement of the specific terms to which the parties might have agreed.

**§ 25-2-205. Firm offers.**—An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 1 and 3, Uniform Sales Act.

**Changes:** Completely rewritten by this and other sections of this Article.

##### Purposes of changes:

1. This section is intended to modify the former rule which required that "firm offers" be sustained by consideration in order to bind, and to require instead that they must merely be characterized as such and expressed in signed writings.

2. The primary purpose of this section is to give effect to the deliberate intention of a merchant to make a current firm offer binding. The deliberation is shown in the case of an individualized document by the merchant's signature to the offer, and in the case of an offer included on a form supplied by the other party to the transaction by the separate signing of the particular clause which contains the offer. "Signed" here also includes authentication but the reasonableness of the authentication herein allowed must be determined in the light of the purpose of the section. The circumstances surrounding the signing may justify something less than a formal signature or initialing but typically the kind of authentication involved here would consist of a minimum of initialing of the clause involved. A handwritten memorandum on the writer's letterhead purporting in its terms to "confirm" a firm offer already made would be enough to satisfy this section, although not subscribed, since under the circumstances it could not be considered a memorandum of mere negotiation and it would adequately show its own authenticity. Similarly, an authorized telegram will suffice, and this is true even though the original draft contained only a typewritten signature. However, despite settled courses of dealing or usages of the trade whereby firm offers are made by oral communication and relied upon without more evidence, such offers remain revocable under this Article since authentication by a writing is the essence of this section.

3. This section is intended to apply to current "firm" offers and not to long term options, and an outside time limit of three months during which such offers remain irrevocable has been set. The three month period during which firm offers remain irrevocable under this section need not be stated by days or by date. If the offer states that it is "guaranteed" or "firm" until the happening of a contingency which will occur within the three month period, it will remain irrevocable until that event. A promise made for a longer period will operate under this section to bind the offeror only for the first three months of the period but may of course be renewed. If supported by consideration it may continue for as long as the parties specify. This section deals only with the offer which is not supported by consideration.

4. Protection is afforded against the inadvertent signing of a firm offer when contained in a form prepared by the offeree by requiring that such a clause be separately authenticated. If the offer clause is called to the offeror's attention and he separately authenticates it, he will be bound; Section 2—302 may operate, however, to prevent an unconscionable result which otherwise would flow from other terms appearing in the form.

5. Safeguards are provided to offer relief in the case of material mistake by virtue of the requirement of good faith and the general law of mistake.

##### Cross references:

- Point 1: Section 1—102.
- Point 2: Section 1—102.
- Point 3: Section 2—201.
- Point 5: Section 2—302.

##### Definitional cross references:

- "Goods". Section 2—105.
- "Merchant". Section 2—104.
- "Signed". Section 1—201.
- "Writing". Section 1—201.

## NORTH CAROLINA COMMENT

This provision reverses prior North Carolina law. If an offer to sell was without consideration, it could be withdrawn by the offeror at any time before acceptance. *Durham Life Ins. Co. v. Moize*, 175 N.C. 344, 95 S.E. 552 (1918); *Winders v. Kenan*, 161 N.C. 628, 77 S.E. 687 (1913); *Paddock v. Davenport*, 107 N.C. 710, 12 S.E. 464 (1890). That an option to pur-

chase under a sealed instrument could not be revoked, see *Thomason v. Bescher*, 176 N.C. 622, 97 S.E. 654 (1918). This section would make firm offers made by merchants binding and irrevocable, even though not supported by consideration or seal.

Note that the section applies only to "merchants."

**§ 25-2-206. Offer and acceptance in formation of contract.—**

(1) Unless otherwise unambiguously indicated by the language or circumstances

(a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;

(b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods, but such a shipment of nonconforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(2) Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 1 and 3, Uniform Sales Act

**Changes:** Completely rewritten in this and other sections of this Article.

**Purposes of changes:** To make it clear that:

1. Any reasonable manner of acceptance is intended to be regarded as available unless the offeror has made quite clear that it will not be acceptable. Former technical rules as to acceptance, such as requiring that telegraphic offers be accepted by telegraphed acceptance, etc., are rejected and a criterion that the acceptance be "in any manner and by any medium reasonable under the circumstances," is substituted. This section is intended to remain flexible and its applicability to be enlarged as new media of communication develop or as the more time-saving present day media come into general use.

2. Either shipment or a prompt promise to ship is made a proper means of acceptance of an offer looking to current shipment. In accordance with ordinary commercial understanding the section interprets an order looking to current shipment as allowing acceptance either by actual shipment or by a prompt promise to ship and rejects the artificial theory that only a single mode of acceptance is normally envisaged by an offer. This is true even though the language of the offer happens to be "ship at once" or the like. "Shipment" is here used in the same sense

as in Section 2—504; it does not include the beginning of delivery by the seller's own truck or by messenger. But loading on the seller's own truck might be a beginning of performance under subsection (2).

3. The beginning of performance by an offeree can be effective as acceptance so as to bind the offeror only if followed within a reasonable time by notice to the offeror. Such a beginning of performance must unambiguously express the offeree's intention to engage himself. For the protection of both parties it is essential that notice follow in due course to constitute acceptance. Nothing in this section however bars the possibility that under the common law performance begun may have an intermediate effect of temporarily barring revocation of the offer, or at the offeror's option, final effect in constituting acceptance.

4. Subsection (1) (b) deals with the situation where a shipment made following an order is shown by a notification of shipment to be referable to that order but has a defect. Such a non-conforming shipment is normally to be understood as intended to close the bargain, even though it proves to have been at the same time a breach. However, the seller by stating that the shipment is non-conforming and is offered only as an accommodation to the buyer keeps the shipment or notification from operating as an acceptance.



**Definitional cross references:**

"Buyer". Section 2—103.

"Conforming". Section 2—106.

"Contract". Section 1—201.

"Goods". Section 2—105.

"Notifies". Section 1—201.

"Reasonable time". Section 1—204.

**NORTH CAROLINA COMMENT**

*Subsection (1) (a)* is designed to reject any technical rules of acceptance of contracts and provides that an offer shall be construed as inviting acceptance in any manner or medium reasonable under the circumstances. This was probably already the law of North Carolina. See *Crook v. Cowan*, 64 N.C. 743 (1870), which holds that while an assent to the terms of an offer is indispensable, it is not material how or through whom it is given. Of course, an offer by mail carries with it an implied invitation, nothing else appearing, that it may be accepted or rejected by mail. See *Board of Educ. v. State Bd. of Educ.*, 217 N.C. 90, 6 S.E.2d 833 (1939). This subsection would appear to accord with reason. Of course, the offeror can specify a particular mode or manner for effective acceptance.

*Subsection (1) (b)* apparently has no parallel in prior North Carolina law and is therefore new. It is designed to resolve a trick problem not evidenced by any North Carolina case. The general principle is that

an order for goods authorizes acceptance by seller's shipment of the goods. *Crook v. Cowan*, 64 N.C. 743 (1870). The trick comes when the seller ships nonconforming goods in response to an order. If these goods were shipped and accepted by the buyer, he had technically accepted a counteroffer. If he rejected the goods, as he had a right to do, he might find himself without any recourse against the seller, as the seller could claim no contract was ever consummated because his acceptance did not conform to the buyer's offer. The Code shifts tactical advantage somewhat. Unless the seller shipping nonconforming goods notifies the buyer that they are being shipped "for accommodation" only, the seller will be held to have accepted the buyer's offer by his shipment—a contract will have been formed.

*Subsection (2)* was probably already the law in North Carolina. (Compare *Crook v. Cowan*, 64 N.C. 743 (1870), dissenting opinion of Rodman, J.)

**§ 25-2-207. Additional terms in acceptance or confirmation.**—(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional or different terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

- (a) the offer expressly limits acceptance to the terms of the offer;
- (b) they materially alter it; or
- (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this chapter. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 1 and 3, Uniform Sales Act.

**Changes:** Completely rewritten by this and other sections of this Article.

**Purposes of changes:**

1. This section is intended to deal with two typical situations. The one is where an agreement has been reached either orally or by informal correspondence between the parties and is followed by one

or both of the parties sending formal acknowledgments or memoranda embodying the terms so far as agreed upon and adding terms not discussed. The other situation is one in which a wire or letter expressed and intended as the closing or confirmation of an agreement adds further minor suggestions or proposals such as "ship by Tuesday," "rush," "ship draft against bill of lading inspection allowed," or the like.

2. Under this Article a proposed deal which in commercial understanding has in fact been closed is recognized as a contract. Therefore, any additional matter contained either in the writing intended to close the deal or in a later confirmation falls within subsection (2) and must be regarded as a proposal for an added term unless the acceptance is made conditional on the acceptance of the additional terms.

3. Whether or not additional or different terms will become part of the agreement depends upon the provisions of subsection (2). If they are such as materially to alter the original bargain, they will not be included unless expressly agreed to by the other party. If, however, they are terms which would not so change the bargain they will be incorporated unless notice of objection to them has already been given or is given within a reasonable time.

4. Examples of typical clauses which would normally "materially alter" the contract and so result in surprise or hardship if incorporated without express awareness by the other party are: a clause negating such standard warranties as that of merchantability or fitness for a particular purpose in circumstances in which either warranty normally attaches; a clause requiring a guaranty of 90% or 100% deliveries in a case such as a contract by cannery, where the usage of the trade allows greater quantity leeways; a clause reserving to the seller the power to cancel upon the buyer's failure to meet any invoice when due; a clause requiring that complaints be made in a time materially shorter than customary or reasonable.

5. Examples of clauses which involve no element of unreasonable surprise and which therefore are to be incorporated in the contract unless notice of objection is seasonably given are: a clause setting forth and perhaps enlarging slightly upon the seller's exemption due to supervening causes beyond his control, similar to those covered by the provision of this Article on merchant's excuse by failure of presupposed conditions or a clause fixing in ad-

vance any reasonable formula of proration under such circumstances; a clause fixing a reasonable time for complaints within customary limits, or in the case of a purchase for sub-sale, providing for inspection by the sub-purchaser; a clause providing for interest on overdue invoices or fixing the seller's standard credit terms where they are within the range of trade practice and do not limit any credit bargained for; a clause limiting the right of rejection for defects which fall within the customary trade tolerances for acceptance "with adjustment" or otherwise limiting remedy in a reasonable manner (see Sections 2-718 and 2-719).

6. If no answer is received within a reasonable time after additional terms are proposed, it is both fair and commercially sound to assume that their inclusion has been assented to. Where clauses on confirming forms sent by both parties conflict, each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself. As a result the requirement that there be notice of objection which is found in subsection (2) is satisfied and the conflicting terms do not become a part of the contract. The contract then consists of the terms originally expressly agreed to, terms on which the confirmations agree, and terms supplied by this Act, including subsection (2).

#### Cross references:

See generally Section 2-302.

Point 5: Sections 2-513, 2-602, 2-607, 2-609, 2-612, 2-614, 2-615, 2-616, 2-718 and 2-719.

Point 6: Sections 1-102 and 2-104.

#### Definitional cross references:

"Between merchants". Section 2-104.

"Contract". Section 1-201.

"Notification". Section 1-201.

"Reasonable time". Section 1-204.

"Seasonably". Section 1-204.

"Send". Section 1-201.

"Term". Section 1-201.

"Written". Section 1-201.

### NORTH CAROLINA COMMENT

This section changes prior North Carolina law. See *Morrison v. Parks*, 164 N.C. 197, 80 S.E. 85 (1913), that for an acceptance of an offer to become a binding contract, it had to be absolute and unconditional and identical with the offer's terms in all respects and where the acceptance was for a lower price, or specified different kinds of goods, the acceptance was conditional and there was

no contract. *Wilson v. W. M. Storey Lumber Co.*, 180 N.C. 271, 104 S.E. 531 (1920). But see *Carver v. Britt*, 241 N.C. 538, 85 S.E.2d 888 (1955), that where an offer was squarely accepted in positive terms, the addition of a statement relating to ultimate performance of the contract did not make the acceptance conditional and prevent the formation of the contract. In other words, if the acceptance

varied materially with the offer and was conditional, there would be no contract. But if the acceptance added terms that were not material or which were minor, or which represented in effect a request, or proposal of alteration or modification, made after an unconditional acceptance of an offer, this would not affect the contract. Compare *Richardson v. Greensboro Warehouse & Storage Co.*, 223 N.C. 344, 26 S.E.2d 897, 149 A.L.R. 201 (1943).

*Subsection (1)*: Under subsection (1) of this section the additional or different terms in the acceptance are not treated as "conditions to acceptance," constituting a counteroffer, but result in a completed contract. The added or different terms set out in the acceptance do not become a part of the contract as between ordinary sellers and purchasers (nonmerchants) but become ad-

denda to the contract which merely "propose" or "suggest" such additional or different terms.

*Subsection (2)*: Under subsection (2), as to "merchants" contracts, if there are additional or different terms in the acceptance or confirmation, the additional or different terms of the acceptance become a part of the contract unless (a) the offer expressly limits acceptance to the terms of the offer; (b) they materially alter it; or (c) notification of objection to such terms is given within a reasonable time.

*Subsection (3)* accords with *J. W. Sanders Cotton Mill v. Capps*, 104 F. Supp. 617 (E.D.N.C. 1952), that an acceptance and a binding contract may result from acts and conduct even though writings of the parties may not by themselves constitute a contract.

**§ 25-2-208. Course of performance or practical construction.**—(1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(2) The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (§ 25-1-205).

(3) Subject to the provisions of the next section [§ 25-2-209] on modification and waiver, such course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance. (1965, c. 700, s. 1.)

**Editor's Note.** — In the parentheses at the end of subsection (2), the 1965 Session Laws have "25A-54," which would be pres-

ent § 25-2-205. Since present § 25-1-205 is the correct reference, it has been used above.

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** No such general provision but concept of this section recognized by terms such as "course of dealing," "the circumstances of the case," "the conduct of the parties," etc., in Uniform Sales Act.

##### Purposes:

1. The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was. This section thus rounds out the set of factors which determines the meaning of the "agreement" and therefore also of the "unless otherwise agreed" qualification to various provisions of this Article.

2. Under this section a course of performance is always relevant to determine the meaning of the agreement. Express mention of course of performance else-

where in this Article carries no contrary implication when there is a failure to refer to it in other sections.

3. Where it is difficult to determine whether a particular act merely sheds light on the meaning of the agreement or represents a waiver of a term of the agreement, the preference is in favor of "waiver" whenever such construction, plus the application of the provisions on the reinstatement of rights waived (see Section 2—209), is needed to preserve the flexible character of commercial contracts and to prevent surprise or other hardship.

4. A single occasion of conduct does not fall within the language of this section but other sections such as the ones on silence after acceptance and failure to specify particular defects can affect the parties' rights on a single occasion (see Sections 2—605 and 2—607).



**Cross references:**

Point 1: Section 1—201.

Point 2: Section 2—202.

Point 3: Sections 2—209, 2—601 and 2—607.

Point 4: Sections 2—605 and 2—607.

**NORTH CAROLINA COMMENT**

*Subsection (1):* There does not seem to be any North Carolina case directly in point with subsection (1), but it seems to accord with prior North Carolina law that an acceptance of an offer (and thus the terms of the contract) may be established by words or conduct showing that the offeree means to accept. If a party declines to speak when speech is admonished at the peril of an inference from silence, his silence may justify an inference that he has agreed to the terms of a contract even though its terms may be otherwise doubtful and ambiguous. See *T. C. May Co. v. Menzies Shoe Co.*, 184 N.C. 150, 113 S.E. 593 (1922). That North Carolina followed

the rule of "practical interpretation" or "practical construction" of contracts is shown by *Cole v. Industrial Fibre Co.*, 200 N.C. 484, 157 S.E. 857 (1931), which states: "The practical interpretation given to their contracts by the parties to them while they are engaged in their performance and before any controversy has arisen concerning them, is one of the best indications of their intent . . ."

*Subsection (2)* accords with *Lamborn v. Woodard*, 20 F.2d 635 (4th Cir. 1927), that custom or usage may explain a doubtful contract but not contradict a plain express one. See also *Cooper v. Purvis*, 46 N.C. 141 (1853).

**§ 25-2-209. Modification, rescission and waiver.**—(1) An agreement modifying a contract within this article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this article (§ 25-2-201) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Subsection (1)—Compare Section 1, Uniform Written Obligations Act; Subsections (2) to (5)—none.

**Purposes of changes and new matter:**

1. This section seeks to protect and make effective all necessary and desirable modifications of sales contracts without regard to the technicalities which at present hamper such adjustments.

2. Subsection (1) provides that an agreement modifying a sales contract needs no consideration to be binding.

However, modifications made thereunder must meet the test of good faith imposed by this Act. The effective use of bad faith to escape performance on the original contract terms is barred, and the extortion of a "modification" without legitimate commercial reason is ineffective as a violation of the duty of good faith. Nor can a mere technical consideration support a modification made in bad faith.

The test of "good faith" between merchants or as against merchants includes "observance of reasonable commercial standards of fair dealing in the trade" (Section 2-103), and may in some situations require an objectively demonstrable reason for seeking a modification. But such matters as a market shift which makes a performance come to involve a loss may provide such a reason even though there is no such unforeseen difficulty as would make out a legal excuse from performance under Sections 2-615 and 2-616.

3. Subsections (2) and (3) are intended to protect against false allegations of oral modifications. "Modification or rescission" includes abandonment or other change by mutual consent, contrary to the decision in *Green v. Doniger*, 300 N.Y. 238, 90 N.E.2d 56 (1949); it does not include unilateral "termination" or "cancellation" as defined in Section 2-106.

The Statute of Frauds provisions of this Article are expressly applied to modifications by subsection (3). Under those provisions the "delivery and acceptance" test is limited to the goods which have been accepted, that is, to the past. "Modification" for the future cannot therefore be conjured up by oral testimony if the price involved is \$500.00 or more since such modification must be shown at least by an authenticated memo. And since a memo is limited in its effect to the quantity of goods set forth in it there is safeguard against oral evidence.

Subsection (2) permits the parties in effect to make their own Statute of Frauds as regards any future modification of the contract by giving effect to a clause in a signed agreement which expressly requires any modification to be by signed writing. But note that if a consumer is to be held to such a clause on a form supplied by a merchant it must be separately signed.

#### NORTH CAROLINA COMMENT

*Subsection (1)* makes a change in prior North Carolina law. North Carolina held that a consideration is necessary in order to make binding an agreement modifying or discharging a contract. See *Lipschutz v. Weatherly*, 140 N.C. 365, 53 S.E. 132 (1906); *Brown v. Catawba River Lumber Co.*, 117 N.C. 287, 23 S.E. 253 (1895).

*Subsection (2)* changes prior North Carolina law. See *Childress v. C. W. Myers Trading Post, Inc.*, 247 N.C. 150, 100 S.E.2d 391 (1957), which holds that a written contract may be modified or waived by a subsequent parol agreement even though the instrument provides that any modification must be in writing. Subsection (2) permits the parties to prescribe their own "statute of frauds" so to speak by requiring modifications of the contract to be in writing. The last part of subsection (2) (after the comma) provides that a merchant-seller's contract form limiting modification by a buyer (who is not a merchant), specifying that it shall be modified only by a writing, will not limit the nonmerchant buyer unless he separately signs the instrument containing such limitation.

*Subsection (3)* makes it clear that if contract as modified would be within the statute of frauds provision, the modification must be in writing.

*Subsection (4)* attempts to provide an equitable solution to situations where there is conduct or parol agreement which would evince intention to modify the contract but

4. Subsection (4) is intended, despite the provisions of subsections (2) and (3), to prevent contractual provisions excluding modification except by a signed writing from limiting in other respects the legal effect of the parties' actual later conduct. The effect of such conduct as a waiver is further regulated in subsection (5).

#### Cross references:

Point 1: Section 1-203.

Point 2: Sections 1-201, 1-203, 2-615 and 2-616.

Point 3: Sections 2-106, 2-201 and 2-202.

Point 4: Sections 2-202 and 2-208.

#### Definitional cross references:

"Agreement". Section 1-201.

"Between merchants". Section 2-104.

"Contract". Section 1-201.

"Notification". Section 1-201.

"Signed". Section 1-201.

"Term". Section 1-201.

"Writing". Section 1-201.

for the requirements of subsections (2) and (3). This subsection would seem to accord with prior law in North Carolina. See *Childress v. C. W. Myers Trading Post, Inc.*, 247 N.C. 150, 100 S.E.2d 391 (1957); *Whitehurst v. FCX Fruit & Vegetable Serv.*, 224 N.C. 628, 32 S.E.2d 34 (1944); *H. M. Wade Mfg. Co. v. Lefkowitz*, 204 N.C. 449, 168 S.E. 517 (1933), which indicate that the doctrine of waiver, in proper cases, is now as firmly established as the doctrine of rigidity and inflexibility of the written word. The latter case defines waiver: "A waiver takes place where a man dispenses with the performance of something which he has a right to exact. A man may do that not only by saying that he dispenses with it, that he excuses the performance, or he may do it as effectually by conduct which naturally and justly leads the other party to believe that he dispenses with it. There can be no waiver unless so intended by one party, and so understood by the other, or one party has so acted as to mislead the other."

Subsection (4), according to the Official Comment, is directed primarily toward conduct after formation of the contract which will constitute a waiver notwithstanding a provision in the contract that excludes modification or rescission except by a signed writing.

*Subsection (5)*: No statutory or decisional parallel has been located concerning the retraction of a waiver as provided for in subsection (5).

§ 25-2-210. Delegation of performance; assignment of rights.—(1)  
A party may perform his duty through a delegate unless otherwise agreed or unless

the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

(2) Unless otherwise agreed all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. A right to damages for breach of the whole contract, or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise.

(3) Unless the circumstances indicate the contrary a prohibition of assignment of "the contract" is to be construed as barring only the delegation to the assignee of the assignor's performance.

(4) An assignment of "the contract" or of "all my rights under the contract" or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

(5) The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee. (§ 25-2-609). (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. Generally, this section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods.

2. Delegation of performance, either in conjunction with an assignment or otherwise, is provided for by subsection (1) where no substantial reason can be shown as to why the delegated performance will not be as satisfactory as personal performance.

3. Under subsection (2) rights which are no longer executory such as a right to damages for breach or a right to payment of an "account" as defined in the Article on Secured Transactions (Article 9) may be assigned although the agreement prohibits assignment. In such cases no question of delegation of any performance is involved. The assignment of a "contract right" as defined in the Article on Secured Transactions (Article 9) is not covered by this subsection.

4. The nature of the contract or the circumstances of the case, however, may bar assignment of the contract even where delegation of performance is not involved. This Article and this section are intended to clarify this problem, particularly in cases dealing with output requirement and exclusive dealing contracts. In the first place the section on requirements and exclusive dealing removes from the construction of the original contract most

of the "personal discretion" element by substituting the reasonably objective standard of good faith operation of the plant or business to be supplied. Secondly, the section on insecurity and assurances, which is specifically referred to in subsection (5) of this section, frees the other party from the doubts and uncertainty which may afflict him under an assignment of the character in question by permitting him to demand adequate assurance of due performance without which he may suspend his own performance. Subsection (5) is not in any way intended to limit the effect of the section on insecurity and assurances and the word "performance" includes the giving of orders under a requirements contract. Of course, in any case where a material personal discretion is sought to be transferred, effective assignment is barred by subsection (2).

5. Subsection (4) lays down a general rule of construction distinguishing between a normal commercial assignment, which substitutes the assignee for the assignor both as to rights and duties, and a financing assignment in which only the assignor's rights are transferred.

This Article takes no position on the possibility of extending some recognition or power to the original parties to work out normal commercial readjustments of the contract in the case of financing assignments even after the original obligor has been notified of the as-



signment. This question is dealt with in the Article on Secured Transactions (Article 9).

6. Subsection (5) recognizes that the non-assigning original party has a stake in the reliability of the person with whom he has closed the original contract, and is, therefore, entitled to due assurance that any delegated performance will be properly forthcoming.

7. This section is not intended as a complete statement of the law of delegation and assignment but is limited to clarifying a few points doubtful under the case law. Particularly, neither this section nor this Article touches directly on such questions as the need or effect of notice of the assignment, the rights of successive assignees, or any question of

the form of an assignment, either as between the parties or as against any third parties. Some of these questions are dealt with in Article 9.

**Cross references:**

Point 3: Articles 5 and 9.

Point 4: Sections 2-306 and 2-609.

Point 5: Article 9, Sections 9-317 and 9-318.

Point 7: Article 9.

**Definitional cross references:**

"Agreement". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Party". Section 1-201.

"Rights". Section 1-201.

"Seller". Section 2-103.

"Term". Section 1-201.

### NORTH CAROLINA COMMENT

*Subsection (1):* The first sentence of subsection (1) is consistent with decisional law in North Carolina that contracts for the sale and purchase of merchandise, not involving a personal element or a relation of personal confidence, are assignable by either party. See *Gulf States Creosoting Co. v. Loving*, 120 F.2d 195 (4th Cir. 1941) and cases there cited. See *Restatement, Contracts* §§ 151, 152 (1932). That executory contracts involving personal confidence or reliance on character, skill, business standing, or capacity cannot be assigned is set forth in *Atlantic & N.C.R.R. v. Atlantic & N.C. Co.*, 147 N.C. 368, 61 S.E. 185 (1908).

The second sentence of subsection (1) also accords with North Carolina decisional law. That a delegation of performance does not relieve the assignor or delegator, see *Atlantic & N.C.R.R. v. Atlantic & N.C. Co.*, 147 N.C. 368, 61 S.E. 185 (1908).

*Subsection (2):* The first sentence of subsection (2) accords with prior North Carolina law. See *Atlantic & N.C.R.R. v. Atlantic & N.C. Co.*, 147 N.C. 368, 61 S.E. 185 (1908). The second sentence of subsection (2) makes choses in action arising out of executed contracts assignable, notwithstanding an agreement in the contract not to assign. While *Gulf States Creosoting Co. v. Loving*, 120 F.2d 195 (4th Cir. 1941), holds that a cause of action for

breach of contract is assignable, the provision in the UCC that a cause of action is assignable despite a contrary agreement will apparently be new in North Carolina.

*Subsection (3)* apparently has no statutory or decisional parallel in North Carolina.

*Subsection (4)* accords with *Atlantic & N.C.R.R. v. Atlantic & N.C. Co.*, 147 N.C. 368, 61 S.E. 185 (1908), that an assignee assumes both the benefits and burdens upon an assignment of a contract. That an assignor can maintain an action against his assignee for nonperformance of duties imposed in an assigned contract is also held in the *Atlantic & N.C.R.R.* case. Implicit also is the rule that a third party who was an original party to a contract assigned may maintain a suit directly against an assignee for nonperformance of the contract assumed. Compare the analogous situation where a transferee of mortgaged property who assumes the obligation which the mortgage secures is directly and personally liable to the holder of the mortgage on the mortgage debt. *Rector v. Lyda*, 180 N.C. 577, 105 S.E. 170 (1920); *Parlier v. Miller*, 186 N.C. 501, 119 S.E. 898 (1923).

*Subsection (5)* making assignment delegating performance grounds for insecurity entitling the other party to further assurances has no parallel in decisional or statutory law in North Carolina.

## PART 3.

### GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT.

§ 25-2-301. **General obligations of parties.**—The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 11 and 41, Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:**

This section uses the term "obligation" in contrast to the term "duty" in order to provide for the "condition" aspects of delivery and payment insofar as they are not modified by other sections of this Article such as those on cure of tender. It thus replaces not only the general provisions of the Uniform Sales Act on the parties' duties, but also the general provisions of that Act on the effect of conditions. In order to determine what is "in accordance with the contract" under this

Article usage of trade, course of dealing and performance, and the general background of circumstances must be given due consideration in conjunction with the lay meaning of the words used to define the scope of the conditions and duties.

**Cross references:**

Section 1—106. See also Sections 1—205, 2—208, 2—209, 2—508 and 2—612.

**Definitional cross references:**

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Party". Section 1—201.

"Seller". Section 2—103.

**NORTH CAROLINA COMMENT**

This section reflects the prior law of North Carolina and would seem to require

no comment. See and compare *McAden v. Craig*, 222 N.C. 497, 24 S.E.2d 1 (1942).

§ 25-2-302: Omitted.

§ 25-2-303. **Allocation or division of risks.**—Where this article allocates a risk or a burden as between the parties "unless otherwise agreed," the agreement may not only shift the allocation but may also divide the risk or burden. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. This section is intended to make it clear that the parties may modify or allocate "unless otherwise agreed" risks or burdens imposed by this Article as they desire, always subject, of course, to the provisions on unconscionability.

Compare Section 1—102(4).

2. The risk or burden may be divided by the express terms of the agreement or

by the attending circumstances, since under the definition of "agreement" in this Act the circumstances surrounding the transaction as well as the express language used by the parties enter into the meaning and substance of the agreement.

**Cross references:**

Point 1: Sections 1—102, 2—302.

Point 2: Section 1—201.

**Definitional cross references:**

"Party". Section 1—201.

"Agreement". Section 1—201.

**NORTH CAROLINA COMMENT**

This section accords with prior North Carolina law. The risk followed title under such law. *Penniman v. Winder*, 180 N.C. 73, 103 S.E. 908 (1920). Title passed according to the intent of the parties. *Teague*

*v. Howard Grocery Store*, 175 N.C. 195, 95 S.E. 173 (1918). Therefore, allocation of risks and burdens could be shifted and allocated by agreement.

§ 25-2-304. **Price payable in money, goods, realty, or otherwise.**—(1) The price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer.

(2) Even though all or part of the price is payable in an interest in realty the transfer of the goods and the seller's obligations with reference to them are subject to this article, but not the transfer of the interest in realty or the transferor's obligations in connection therewith. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Subsections (2) and (3) of Section 9, Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:**

1. This section corrects the phrasing of the Uniform Sales Act so as to avoid misconstruction and produce greater accu-

racy in commercial result. While it continues the essential intent and purpose of the Uniform Sales Act it rejects any purely verbalistic construction in disregard of the underlying reason of the provisions.

2. Under subsection (1) the provisions of this Article are applicable to transactions where the "price" of goods is payable in something other than money. This does not mean, however, that this whole Article applies automatically and in its entirety simply because an agreed transfer of title to goods is not a gift. The basic purposes and reasons of the Article must always be considered in determining the applicability of any of its provisions.

3. Subsection (2) lays down the general principle that when goods are to be exchanged for realty, the provisions of this Article apply only to those aspects of the transaction which concern the transfer of title to goods but do not affect the transfer of the realty since the detailed regula-

tion of various particular contracts which fall outside the scope of this Article is left to the courts and other legislation. However, the complexities of these situations may be such that each must be analyzed in the light of the underlying reasons in order to determine the applicable principles. Local statutes dealing with realty are not to be lightly disregarded or altered by language of this Article. In contrast, this Article declares definite policies in regard to certain matters legitimately within its scope though concerned with real property situations, and in those instances the provisions of this Article control.

#### Cross references:

Point 1: Section 1—102.

Point 3: Sections 1—102, 1—103, 1—104 and 2—107.

#### Definitional cross references:

"Goods". Section 2—105.

"Money". Section 1—201.

"Party". Section 1—201.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

This would not materially change the prior law of sales, but *State v. Albarty*, 238 N.C. 130, 76 S.E.2d 381 (1953), holds that for purposes of criminal law a barter is not a sale. See, however, *State v. Colonial Club*, 154 N.C. 177, 69 S.E. 771 (1910), that a sale is a transmutation of property from one man to another in con-

sideration of some price or recompense in value.

The UCC adds, however, the idea that both traders in a barter situation are both sellers. The UCC provides that the rules herein stated will govern only the barterer of personal property if land is bartered for personal property.

**§ 25-2-305. Open price term.**—(1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if

- (a) nothing is said as to price; or
- (b) the price is left to be agreed by the parties and they fail to agree; or
- (c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 9 and 10, Uniform Sales Act.

**Changes:** Completely rewritten.

**Purposes of changes:**

1. This section applies when the price term is left open on the making of an agreement which is nevertheless intended

by the parties to be a binding agreement. This Article rejects in these instances the formula that "an agreement to agree is unenforceable" if the case falls within subsection (1) of this section, and rejects also defeating such agreements on the ground of "indefiniteness". Instead this



Article recognizes the dominant intention of the parties to have the deal continue to be binding upon both. As to future performance, since this Article recognizes remedies such as cover (Section 2-712), resale (Section 2-706) and specific performance (Section 2-716) which go beyond any mere arithmetic as between contract price and market price, there is usually a "reasonably certain basis for granting an appropriate remedy for breach" so that the contract need not fail for indefiniteness.

2. Under some circumstances the postponement of agreement on price will mean that no deal has really been concluded, and this is made express in the preamble of subsection (1) ("The parties *if they so intend*") and in subsection (4). Whether or not this is so is, in most cases, a question to be determined by the trier of fact.

3. Subsection (2), dealing with the situation where the price is to be fixed by one party rejects the uncommercial idea that an agreement that the seller may fix the price means that he may fix any price he may wish by the express qualification that the price so fixed must be fixed in good faith. Good faith includes observance of reasonable commercial standards of fair dealing in the trade if the party is a merchant. (Section 2-103). But in the normal case a "posted price" or a future seller's or buyer's "given price," "price in effect," "market price," or the like satisfies the good faith requirement.

4. The section recognizes that there may be cases in which a particular person's judgment is not chosen merely as a barometer or index of a fair price but is an essential condition to the parties' intent to make any contract at all. For example, the case where a known and trusted expert is to "value" a particular

painting for which there is no market standard differs sharply from the situation where a named expert is to determine the grade of cotton, and the difference would support a finding that in the one the parties did not intend to make a binding agreement if that expert were unavailable whereas in the other they did so intend. Other circumstances would of course affect the validity of such a finding.

5. Under subsection (3), wrongful interference by one party with any agreed machinery for price fixing in the contract may be treated by the other party as a repudiation justifying cancellation, or merely as a failure to take cooperative action thus shifting to the aggrieved party the reasonable leeway in fixing the price.

6. Throughout the entire section, the purpose is to give effect to the agreement which has been made. That effect, however, is always conditioned by the requirement of good faith action which is made an inherent part of all contracts within this Act. (Section 1-203).

#### Cross references:

Point 1: Sections 2-204(3), 2-706, 2-712 and 2-716.

Point 3: Section 2-103.

Point 5: Sections 2-311 and 2-610.

Point 6: Section 1-203.

#### Definitional cross references:

"Agreement". Section 1-201.

"Burden of establishing". Section 1-201.

"Buyer". Section 2-103.

"Cancellation". Section 2-106.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Fault". Section 1-201.

"Goods". Section 2-105.

"Party". Section 1-201.

"Receipt of goods". Section 2-103.

"Seller". Section 2-103.

"Term". Section 1-201.

### NORTH CAROLINA COMMENT

*Subsection (1):* Subsections (1) (a) and (b), which state that parties can conclude a sales contract even though the price is not settled, conflict with and change North Carolina law as set out in *Wittkowsky v. Wasson*, 71 N.C. 451 (1874): "There cannot be an executed sale as to pass the property where the price is to be fixed by agreement between the parties afterwards, and the parties do not afterwards agree." If, however, the thing sold has been delivered to the vendee and consumed, so that the parties cannot be put in *statu quo*, the vendee is liable for a reasonable price. Benjamin, Sales, quoted with approval in *Wittkowsky v. Wasson*, 71 N.C. 451 (1874).

There are apparently no cases on subsection (1) (c), but it would also conflict with the reasoning of the *Wittkowsky* case.

*Subsection (2):* There are apparently no cases relating exactly to subsection (2), but it seems to change the contracts rule set forth in *Kirby v. Stokes County Bd. of Educ.*, 230 N.C. 619, 55 S.E.2d 322 (1949) that: "One of the essential elements of every contract is mutuality of agreement. There must be neither doubt nor difference between the parties. They must assent to the same thing in the same sense and their minds must meet as to all the terms. If any portion of the proposed terms is not settled, or no mode agreed on by which they may be settled, there is no agreement."

Compare *Richardson v. Greensboro Warehouse & Storage Co.*, 223 N.C. 344, 26 S.E.2d 897, 149 A.L.R. 201 (1943).

It would seem that under this UCC section contracts of sale are enforceable that would not have been enforceable under prior North Carolina Law.

*Subsections (3) and (4):* There are no par-

allels in prior North Carolina law to the other subsections of GS 25-2-305.

It should be noted that subsection (4), as well as the first sentence of this section, pays careful attention to the intention of the parties and a contract is not enforceable under the conditions set out unless the contracting parties intend to be bound.

**§ 25-2-306. Output, requirements and exclusive dealings.**—(1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.

(2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. Subsection (1) of this section, in regard to output and requirements, applies to this specific problem, the general approach of this Act which requires the reading of commercial background and intent into the language of any agreement and demands good faith in the performance of that agreement. It applies to such contracts of nonproducing establishments such as dealers or distributors as well as to manufacturing concerns.

2. Under this Article, a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party. Nor does such a contract lack mutuality of obligation since, under this section, the party who will determine quantity is required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade so that his output or requirements will approximate a reasonably foreseeable figure. Reasonable elasticity in the requirements is expressly envisaged by this section and good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance. A shut-down by a requirements buyer for lack of orders might be permissible when a shut-down merely to curtail losses would not. The essential test is whether the party is acting in good faith. Similarly, a sudden expansion of the plant by which requirements are to be measured would not be included within the scope of the contract as made but normal expansion undertaken in good faith would be

within the scope of this section. One of the factors in an expansion situation would be whether the market price had risen greatly in a case in which the requirements contract contained a fixed price. Reasonable variation of an extreme sort is exemplified in *Southwest Natural Gas Co. v. Oklahoma Portland Cement Co.*, 102 F.2d 630 (C.C.A. 10, 1939). This Article takes no position as to whether a requirements contract is a provable claim in bankruptcy.

3. If an estimate of output or requirements is included in the agreement, no quantity unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement shows a clear limit on the intended elasticity. In similar fashion, the agreed estimate is to be regarded as a center around which the parties intend the variation to occur.

4. When an enterprise is sold, the question may arise whether the buyer is bound by an existing output or requirements contract. That question is outside the scope of this Article, and is to be determined on other principles of law. Assuming that the contract continues, the output or requirements in the hands of the new owner continue to be measured by the actual good faith output or requirements under the normal operation of the enterprise prior to sale. The sale itself is not grounds for sudden expansion or decrease.

5. Subsection (2), on exclusive dealing, makes explicit the commercial rule embodied in this Act under which the parties to such contracts are held to have impliedly, even when not expressly, bound themselves to use reasonable dili-

gence as well as good faith in their performance of the contract. Under such contracts the exclusive agent is required, although no express commitment has been made, to use reasonable effort and due diligence in the expansion of the market or the promotion of the product, as the case may be. The principal is expected under such a contract to refrain from supplying any other dealer or agent within the exclusive territory. An exclusive dealing agreement brings into play all of the good faith aspects of the output and requirement problems of subsection (1). It also raises questions of insecurity and

right to adequate assurance under this Article.

**Cross references:**

Point 4: Section 2—210.

Point 5: Sections 1—203 and 2—609.

**Definitional cross references:**

"Agreement". Section 1—201.

"Buyer". Section 2—103.

"Contract for sale". Section 2—106.

"Good faith". Section 1—201.

"Goods". Section 2—105.

"Party". Section 1—201.

"Term". Section 1—201.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

North Carolina accords with subsection (1). North Carolina has recognized "output" and "requirements" contracts. *Herren v. Gaines*, 63 N.C. 72 (1868); *Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co.*, 134 N.C. 574, 47 S.E. 116

(1904). The limitation to "good faith output" and "good faith requirements" apparently has no parallel in North Carolina, although such limitation seems reasonable.

No North Carolina authority has been found upon subsection (2).

§ 25-2-307. **Delivery in single lot or several lots.**—Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery and payment is due only on such tender but where the circumstances give either party the right to make or demand delivery in lots the price if it can be apportioned may be demanded for each lot. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 45(1), Uniform Sales Act.

**Changes:** Rewritten and expanded.

**Purposes of changes:**

1. This section applies where the parties have not specifically agreed whether delivery and payment are to be by lots and generally continues the essential intent of original Act, Section 45(1) by assuming that the parties intended delivery to be in a single lot.

2. Where the actual agreement or the circumstances do not indicate otherwise, delivery in lots is not permitted under this section and the buyer is properly entitled to reject for a deficiency in the tender, subject to any privilege in the seller to cure the tender.

3. The "but" clause of this section goes to the case in which it is not commercially feasible to deliver or to receive the goods in a single lot as for example, where a contract calls for the shipment of ten carloads of coal and only three cars are available at a given time. Similarly, in a contract involving brick necessary to build a building the buyer's storage space may be limited so that it would be impossible to receive the entire amount of brick at once, or it may be necessary to assemble the goods as in the

case of cattle on the range, or to mine them.

In such cases, a partial delivery is not subject to rejection for the defect in quantity alone, if the circumstances do not indicate a repudiation or default by the seller as to the expected balance or do not give the buyer ground for suspending his performance because of insecurity under the provisions of Section 2—609. However, in such cases the undelivered balance of goods under the contract must be forthcoming within a reasonable time and in a reasonable manner according to the policy of Section 2—503 on manner of tender of delivery. This is reinforced by the express provisions of Section 2—608 that if a lot has been accepted on the reasonable assumption that its nonconformity will be cured, the acceptance may be revoked if the cure does not seasonably occur. The section rejects the rule of *Kelly Construction Co. v. Hackensack Brick Co.*, 91 N.J.L. 585, 103 A. 417, 2 A.L.R. 685 (1918) and approves the result in *Lynn M. Ranger, Inc. v. Gildersleeve*, 106 Conn. 372, 138 A. 142 (1927) in which a contract was made for six carloads of coal then rolling from the mines and consigned to the seller but the seller agreed to divert the carloads to



the buyer as soon as the car numbers became known to him. He arranged a diversion of two cars and then notified the buyer who then repudiated the contract. The seller was held to be entitled to his full remedy for the two cars diverted because simultaneous delivery of all of the cars was not contemplated by either party.

4. Where the circumstances indicate that a party has a right to delivery in lots, the price may be demanded for each lot if it is apportionable.

#### Cross references:

Point 1: Section 1—201.

Point 2: Sections 2—508 and 2—601.

Point 3: Sections 2—503, 2—608 and 2—609.

#### Definitional cross references:

"Contract for sale". Section 2—106.

"Goods". Section 2—105.

"Lot". Section 2—105.

"Party". Section 1—201.

"Rights". Section 1—201.

### NORTH CAROLINA COMMENT

There are apparently no North Carolina statutes or cases which relate directly to

the subject matter of this section. It is therefore new.

§ 25-2-308. **Absence of specified place for delivery.**—Unless otherwise agreed

(a) the place for delivery of goods is the seller's place of business or if he has none, his residence; but

(b) in a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and

(c) documents of title may be delivered through customary banking channels. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Paragraphs (a) and (b)—Section 43(1), Uniform Sales Act; Paragraph (c)—none.

**Changes:** Slight modification in language.

#### Purposes of changes and new matter:

1. Paragraphs (a) and (b) provide for those noncommercial sales and for those occasional commercial sales where no place or means of delivery has been agreed upon by the parties. Where delivery by carrier is "required or authorized by the agreement", the seller's duties as to delivery of the goods are governed not by this section but by Section 2—504.

2. Under paragraph (b) when the identified goods contracted for are known to both parties to be in some location other than the seller's place of business or residence, the parties are presumed to have intended that place to be the place of delivery. This paragraph also applies (unless, as would be normal, the circumstances show that delivery by way of documents is intended) to a bulk of goods in the possession of a bailee. In such a case, however, the seller has the additional obligation to procure the acknowledgment by the bailee of the buyer's right to possession.

3. Where "customary banking channels" call only for due notification by the banker that the documents are on hand, leaving the buyer himself to see to the physical receipt of the goods, tender at

the buyer's address is not required under paragraph (c). But that paragraph merely eliminates the possibility of a default by the seller if "customary banking channels" have been properly used in giving notice to the buyer. Where the bank has purchased a draft accompanied by documents or has undertaken its collection on behalf of the seller, Part 5 of Article 4 spells out its duties and relations to its customer. Where the documents move forward under a letter of credit the Article on Letters of Credit spells out the duties and relations between the bank, the seller and the buyer.

4. The rules of this section apply only "unless otherwise agreed." The surrounding circumstances, usage of trade, course of dealing and course of performance, as well as the express language of the parties, may constitute an "otherwise agreement".

#### Cross references:

Point 1: Sections 2—504 and 2—505.

Point 2: Section 2—503.

Point 3: Section 2—512, Articles 4, Part 5, and 5.

#### Definitional cross references:

"Contract for sale". Section 2—106.

"Delivery". Section 1—201.

"Document of title". Section 1—201.

"Goods". Section 2—105.

"Party". Section 1—201.

"Seller". Section 2—103.

## NORTH CAROLINA COMMENT

Subsection (a) accords with prior North Carolina law that where no place for delivery is specified and no contrary intention is shown, the place of delivery is the seller's place of business. See *Fruit Growers' Ex-*

*press Co. v. Plate Ice Co.*, 59 F.2d 605 (4th Cir. 1935). There seems to be no North Carolina authority as to the other two subsections.

§ 25-2-309. **Absence of specific time provisions; notice of termination.**—(1) The time for shipment or delivery or any other action under a contract if not provided in this article or agreed upon shall be a reasonable time.

(2) Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party.

(3) Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Subsection (1)—see Sections 43(2), 45(2), 47(1) and 48, Uniform Sales Act, for policy continued under this Article, Subsection (2)—none; Subsection (3)—none.

**Changes:** Completely different in scope.

**Purposes of changes and new matter:**

1. Subsection (1) requires that all actions taken under a sales contract must be taken within a reasonable time where no time has been agreed upon. The reasonable time under this provision turns on the criteria as to "reasonable time" and on good faith and commercial standards set forth in Sections 1—203, 1—204 and 2—103. It thus depends upon what constitutes acceptable commercial conduct in view of the nature, purpose and circumstances of the action to be taken. Agreement as to a definite time, however, may be found in a term implied from the contractual circumstances, usage of trade or course of dealing or performance as well as in an express term. Such cases fall outside of this subsection since in them the time for action is "agreed" by usage.

2. The time for payment, where not agreed upon, is related to the time for delivery; the particular problems which arise in connection with determining the appropriate time of payment and the time for any inspection before payment which is both allowed by law and demanded by the buyer are covered in Section 2—513.

3. The facts in regard to shipment and delivery differ so widely as to make detailed provision for them in the text of this Article impracticable. The applicable principles, however, make it clear that surprise is to be avoided, good faith judgment is to be protected, and notice or

negotiation to reduce the uncertainty to certainty is to be favored.

4. When the time for delivery is left open, unreasonably early offers of or demands for delivery are intended to be read under this Article as expressions of desire or intention, requesting the assent or acquiescence of the other party, not as final positions which may amount without more to breach or to create breach by the other side. See Sections 2—207 and 2—609.

5. The obligation of good faith under this Act requires reasonable notification before a contract may be treated as breached because a reasonable time for delivery or demand has expired. This operates both in the case of a contract originally indefinite as to time and of one subsequently made indefinite by waiver.

When both parties let an originally reasonable time go by in silence, the course of conduct under the contract may be viewed as enlarging the reasonable time for tender or demand of performance. The contract may be terminated by abandonment.

6. Parties to a contract are not required in giving reasonable notification to fix, at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later trier of fact. Effective communication of a proposed time limit calls for a response, so that failure to reply will make out acquiescence. Where objection is made, however, or if the demand is merely for information as to when goods will be delivered or will be ordered out, demand for assurances on the ground of insecurity may be made under this Article pending further negotiations. Only when a party insists on undue delay or on rejection of

the other party's reasonable proposal is there a question of flat breach under the present section.

7. Subsection (2) applies a commercially reasonable view to resolve the conflict which has arisen in the cases as to contracts of indefinite duration. The "reasonable time" of duration appropriate to a given arrangement is limited by the circumstances. When the arrangement has been carried on by the parties over the years, the "reasonable time" can continue indefinitely and the contract will not terminate until notice.

8. Subsection (3) recognizes that the application of principles of good faith and sound commercial practice normally call for such notification of the termination of a going contract relationship as will give the other party reasonable time to seek a substitute arrangement. An agreement dispensing with notification or limiting the time for the seeking of a substitute arrangement is, of course, valid under this subsection unless the results of putting it into operation would be the creation of an unconscionable state of affairs.

#### NORTH CAROLINA COMMENT

*Subsection (1)* accords with prior North Carolina law. See *Ober & Sons Co. v. Katzenstein*, 160 N.C. 439, 76 S.E. 476 (1912), which holds that when no time for shipment is specified in contract for sale of goods, there is an implied understanding that shipment will be within a reasonable time. If no particular time is set in contract for delivery, it must be within a reasonable time. *Hurlburt v. Simpson*, 25 N.C. 233 (1842); *J. B. Colt Co. v. Kimball*, 190 N.C. 169, 129 S.E. 406 (1925).

**§ 25-2-310. Open time for payment or running of credit; authority to ship under reservation.**—Unless otherwise agreed

(a) payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery; and

(b) if the seller is authorized to send the goods he may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due unless such inspection is inconsistent with the terms of the contract (§ 25-2-513); and

(c) if delivery is authorized and made by way of documents of title otherwise than by subsection (b) then payment is due at the time and place at which the buyer is to receive the documents regardless of where the goods are to be received; and

(d) where the seller is required or authorized to ship the goods on credit the credit period runs from the time of shipment but postdating the invoice or intentionally delaying its dispatch will correspondingly delay the starting of the credit period. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 42 and 47(2), Uniform Sales Act.

**Changes:** Completely rewritten in this and other sections.

9. Justifiable cancellation for breach is a remedy for breach and is not the kind of termination covered by the present subsection.

10. The requirement of notification is dispensed with where the contract provides for termination on the happening of an "agreed event." "Event" is a term chosen here to contrast with "option" or the like.

#### Cross references:

Point 1: Sections 1—203, 1—204 and 2—103.

Point 2: Sections 2—320, 2—321, 2—504, and 2—511 through 2—514.

Point 5: Section 1—203.

Point 6: Section 2—609.

Point 7: Section 2—204.

Point 9: Sections 2—106, 2—318, 2—610 and 2—703.

#### Definitional cross references:

"Agreement". Section 1—201.

"Contract". Section 1—201.

"Notification". Section 1—201.

"Party". Section 1—201.

"Reasonable time". Section 1—204.

"Termination". Section 2—106.

*Subsections (2) and (3)* also accord with prior North Carolina law that a contract calling for successive and continuing performances, wherein no time is fixed during which the contract is to last and none is fixed by usage, may be terminated at the will of either of the parties upon notice being given to the other party. See *Pool v. Walker*, 156 N.C. 40, 72 S.E. 70 (1911). The UCC provision requires "reasonable notification" which is probably implicit in the North Carolina decision.



**Purposes of changes:** This section is drawn to reflect modern business methods of dealing at a distance rather than face to face. Thus:

1. Paragraph (a) provides that payment is due at the time and place "the buyer is to receive the goods" rather than at the point of delivery except in documentary shipment cases (paragraph (c)). This grants an opportunity for the exercise by the buyer of his preliminary right to inspection before paying even though under the delivery term the risk of loss may have previously passed to him or the running of the credit period has already started.

2. Paragraph (b) while providing for inspection by the buyer before he pays, protects the seller. He is not required to give up possession of the goods until he has received payment, where no credit has been contemplated by the parties. The seller may collect through a bank by a sight draft against an order bill of lading "hold until arrival; inspection allowed." The obligations of the bank under such a provision are set forth in Part 5 of Article 4. In the absence of a credit term, the seller is permitted to ship under reservation and if he does payment is then due where and when the buyer is to receive the documents.

3. Unless otherwise agreed, the place for the receipt of the documents and payment is the buyer's city but the time for payment is only after arrival of the goods, since under paragraph (b), and Sections 2-512 and 2-513 the buyer is under no duty to pay prior to inspection.

4. Where the mode of shipment is such that goods must be unloaded immediately upon arrival, too rapidly to permit ade-

quate inspection before receipt, the seller must be guided by the provisions of this Article on inspection which provide that if the seller wishes to demand payment before inspection, he must put an appropriate term into the contract. Even requiring payment against documents will not of itself have this desired result if the documents are to be held until the arrival of the goods. But under (b) and (c) if the terms are C.I.F., C.O.D., or cash against documents payment may be due before inspection.

5. Paragraph (d) states the common commercial understanding that an agreed credit period runs from the time of shipment or from that dating of the invoice which is commonly recognized as a representation of the time of shipment. The provision concerning any delay in sending forth the invoice is included because such conduct results in depriving the buyer of his full notice and warning as to when he must be prepared to pay.

#### **Cross references:**

Generally: Part 5.

Point 1: Section 2-509.

Point 2: Sections 2-505, 2-511, 2-512, 2-513 and Article 4.

Point 3: Sections 2-308(b), 2-512 and 2-513.

Point 4: Section 2-513(3) (b).

#### **Definitional cross references:**

"Buyer". Section 2-103.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Goods". Section 2-105.

"Receipt of goods". Section 2-103.

"Seller". Section 2-103.

"Send". Section 1-201.

"Term". Section 1-201.

### **NORTH CAROLINA COMMENT**

*Subsection (a)* accords with prior North Carolina law which makes the payment of money and the delivery of property simultaneous or concurrent conditions. *McAden v. Craig*, 222 N.C. 497, 24 S.E.2d 1 (1942); *Hughes v. Knott*, 138 N.C. 105, 50 S.E. 586 (1905); *Wessel v. Seminole Phosphate Co.*, 13 F.2d 999 (4th Cir. 1926).

*Subsection (b)* accords with *Standard Paint & Lead Works v. Spruill*, 186 N.C. 68, 118 S.E. 891 (1923), that goods shipped from a distance point are subject to in-

spection by the buyer before he becomes liable for the purchase price in the absence of a contractual provision to the contrary.

*Subsection (c)* accords with common commercial understanding that shipment under C.O.D. contracts and the like deprives the buyer of the right to inspect goods shipped prior to payment. Delivery is not to be made in C.O.D. shipments until payment has been made.

*Subsection (d)* has no statutory or decisional parallel.

**§ 25-2-311. Options and cooperation respecting performance.**—(1) An agreement for sale which is otherwise sufficiently definite (subsection (3) of § 25-2-204) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within limits set by commercial reasonableness.

(2) Unless otherwise agreed specifications relating to assortment of the goods

are at the buyer's option and except as otherwise provided in subsections (1) (c) and (3) of § 25-2-319 specifications or arrangements relating to shipment are at the seller's option.

(3) Where such specification would materially affect the other party's performance but is not seasonably made or where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies

(a) is excused for any resulting delay in his own performance; and

(b) may also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

#### Purposes:

1. Subsection (1) permits the parties to leave certain detailed particulars of performance to be filled in by either of them without running the risk of having the contract invalidated for indefiniteness. The party to whom the agreement gives power to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise and the range of permissible variation is limited by what is commercially reasonable. The "agreement" which permits one party so to specify may be found as well in a course of dealing, usage of trade, or implication from circumstances as in explicit language used by the parties.

2. Options as to assortment of goods or shipping arrangements are specifically reserved to the buyer and seller respectively under subsection (2) where no other arrangement has been made. This section rejects the test which mechanically and without regard to usage or the purpose of the option gave the option to the party "first under a duty to move" and applies instead a standard commercial interpretation to these circumstances. The "unless otherwise agreed" provision of this subsection covers not only express terms but the background and circumstances which enter into the agreement.

3. Subsection (3) applies when the exercise of an option or cooperation by one party is necessary to or materially affects the other party's performance, but it is not seasonably forthcoming; the subsection relieves the other party from the

necessity for performance or excuses his delay in performance as the case may be. The contract-keeping party may at his option under this subsection proceed to perform in any commercially reasonable manner rather than wait. In addition to the special remedies provided, this subsection also reserves "all other remedies". The remedy of particular importance in this connection is that provided for insecurity. Request may also be made pursuant to the obligation of good faith for a reasonable indication of the time and manner of performance for which a party is to hold himself ready.

4. The remedy provided in subsection (3) is one which does not operate in the situation which falls within the scope of Section 2-164 on substituted performance. Where the failure to cooperate results from circumstances set forth in that section, the other party is under a duty to proffer or demand (as the case may be) substitute performance as a condition to claiming rights against the non-cooperating party.

#### Cross references:

Point 1: Sections 1—201, 2—204 and 1—203.

Point 3: Sections 1—203 and 2—609.

Point 4: Section 2—614.

#### Definitional cross references:

"Agreement". Section 1—201.

"Buyer". Section 2—103.

"Contract for sale". Section 2—106.

"Goods". Section 2—105.

"Party". Section 1—201.

"Remedy". Section 1—201.

"Seasonably". Section 1—204.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

The entire section is new and seems to change prior North Carolina law. It states that a contract of sale is not made invalid because particulars of performance are left to be specified by one of the parties. That such particulars of performance may be made by one of the parties and the contract

is binding if he acts in good faith and with-in commercial reasonableness.

This seems to conflict with the statement in Kirby v. Stokes County Bd. of Educ., 230 N.C. 619, 55 S.E.2d 322 (1949), that: "One of the essential elements of every contract is mutuality of agreement.

There must be neither doubt nor difference between the parties. They must assent to the same thing in the same sense, and their minds must meet as to all the terms. If any portion of the proposed terms is not settled, or no mode agreed on which they may be settled, there is no agreement." Compare *Richardson v. Greensboro Warehouse &*

*Storage Co.*, 223 N.C. 344, 26 S.E.2d 897, 149 A.L.R. 201 (1943).

It would seem to be a question of materiality under prior North Carolina Law as to whether omitted terms of the contract might be supplied unilaterally by the parties or by the court.

**§ 25-2-312. Warranty of title and against infringement; buyer's obligation against infringement.**—(1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that

(a) the title conveyed shall be good, and its transfer rightful; and

(b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 13. Uniform Sales Act.

**Changes:** Completely rewritten, the provisions concerning infringement being new.

##### Purposes of changes:

1. Subsection (1) makes provision for a buyer's basic needs in respect to a title which he in good faith expects to acquire by his purchase, namely, that he receive a good, clean title transferred to him also in a rightful manner so that he will not be exposed to a lawsuit in order to protect it.

The warranty extends to a buyer whether or not the seller was in possession of the goods at the time the sale or contract to sell was made.

The warranty of quiet possession is abolished. Disturbance of quiet possession, although not mentioned specifically, is one way, among many, in which the breach of the warranty of title may be established.

The "knowledge" referred to in subsection 1(b) is actual knowledge as distinct from notice.

2. The provisions of this Article requiring notification to the seller within a reasonable time after the buyer's discovery of a breach apply to notice of a breach of the warranty of title, where the seller's breach was innocent. However, if the seller's breach was in bad faith he cannot be permitted to claim that he has been misled or prejudiced by the delay in giving

notice. In such case the "reasonable" time for notice should receive a very liberal interpretation. Whether the breach by the seller is in good or bad faith Section 2—725 provides that the cause of action accrues when the breach occurs. Under the provisions of that section the breach of the warranty of good title occurs when tender of delivery is made since the warranty is not one which extends to "future performance of the goods."

3. When the goods are part of the seller's normal stock and are sold in his normal course of business, it is his duty to see that no claim of infringement of a patent or trademark by a third party will mar the buyer's title. A sale by a person other than a dealer, however, raises no implication in its circumstances of such a warranty. Nor is there such an implication when the buyer orders goods to be assembled, prepared or manufactured on his own specifications. If, in such a case, the resulting product infringes a patent or trademark, the liability will run from buyer to seller. There is, under such circumstances, a tacit representation on the part of the buyer that the seller will be safe in manufacturing according to the specifications, and the buyer is under an obligation in good faith to indemnify him for any loss suffered.

4. This section rejects the cases which recognize the principle that infringements violate the warranty of title but deny the buyer a remedy unless he has been



expressly prevented from using the goods. Under this Article "eviction" is not a necessary condition to the buyer's remedy since the buyer's remedy arises immediately upon receipt of notice of infringement; it is merely one way of establishing the fact of breach.

5. Subsection (2) recognizes that sales by sheriffs, executors, foreclosing lienors and persons similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right. This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.

### NORTH CAROLINA COMMENT

*Subsection (1)* accords with prior North Carolina law that upon sale of a chattel the seller impliedly warrants that the seller has good title. *Lanier v. Auld's Adm'r*, 5 N.C. 138 (1806); *Seymour v. W. S. Boyd Sales Co.*, 257 N.C. 603, 127 S.E.2d 265 (1960). In sales of personal property there is an implied warranty of good title upon the part of the vendor, and this warranty extends to and protects against liens, charges, and encumbrances by which the title is rendered imperfect and the value depreciated thereby.

*Subsection (2)*: It is uncertain whether subsection (2) accords with prior North

6. The warranty of subsection (1) is not designated as an "implied" warranty, and hence is not subject to Section 2-316 (3). Disclaimer of the warranty of title is governed instead by subsection (2), which requires either specific language or the described circumstances.

#### Cross references:

Point 1: Section 2-403.

Point 2: Sections 2-607 and 2-725.

Point 3: Section 1-203.

Point 4: Sections 2-609 and 2-725.

Point 6: Section 2-316.

#### Definitional cross references:

"Buyer". Section 2-103.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Person". Section 1-201.

"Right". Section 1-201.

"Seller". Section 2-103.

Carolina law. The question of whether a disclaimer of warranty operates to negate the implied warranty of title is expressly not decided in *Seymour v. W. S. Boyd Sales Co.*, 257 N.C. 603, 127 S.E.2d 265 (1960). This UCC provision makes it clear that a warranty of title can be disclaimed or modified only by clear specific language or acts indicating a negation of the warranty. This accords with the general law of sales. See *Vold*, Sales 444.

*Subsection (3)* relating to warranty against infringement is new in North Carolina.

**§ 25-2-313. Express warranties by affirmation, promise, description, sample.**—(1) Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 12, 14 and 16, Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To consolidate and systematize basic principles with the result that:

1. "Express" warranties rest on "dickered" aspects of the individual bargain, and go so clearly to the essence of that bargain that words of disclaimer in a form are repugnant to the basic dickered terms. "Implied" warranties rest so clearly

on a common factual situation or set of conditions that no particular language or action is necessary to evidence them and they will arise in such a situation unless unmistakably negated.

This section reverts to the older case law insofar as the warranties of description and sample are designated "express" rather than "implied".

2. Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. The provisions of Section 2—318 on third party beneficiaries expressly recognize this case law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of this Act may offer useful guidance in dealing with further cases as they arise.

3. The present section deals with affirmations of fact by the seller, descriptions of the goods or exhibitions of samples, exactly as any other part of a negotiation which ends in a contract is dealt with. No specific intention to make a warranty is necessary if any of these factors is made part of the basis of the bargain. In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as part of the description of those goods; hence no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement. Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof. The issue normally is one of fact.

4. In view of the principle that the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller's obligation. Thus, a contract is normally a contract for a sale of something describable and described. A clause generally disclaiming "all warranties, express or implied" cannot reduce the seller's obli-

gation with respect to such description and therefore cannot be given literal effect under Section 2—316.

This is not intended to mean that the parties, if they consciously desire, cannot make their own bargain as they wish. But in determining what they have agreed upon good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation.

5. Paragraph (1) (b) makes specific some of the principles set forth above when a description of the goods is given by the seller.

A description need not be by words. Technical specifications, blueprints and the like can afford more exact description than mere language and if made part of the basis of the bargain goods must conform with them. Past deliveries may set the description of quality, either expressly or impliedly by course of dealing. Of course, all descriptions by merchants must be read against the applicable trade usages with the general rules as to merchantability resolving any doubts.

6. The basic situation as to statements affecting the true essence of the bargain is no different when a sample or model is involved in the transaction. This section includes both a "sample" actually drawn from the bulk of goods which is the subject matter of the sale, and a "model" which is offered for inspection when the subject matter is not at hand and which has not been drawn from the bulk of the goods.

Although the underlying principles are unchanged, the facts are often ambiguous when something is shown as illustrative, rather than as a straight sample. In general, the presumption is that any sample or model just as any affirmation of fact is intended to become a basis of the bargain. But there is no escape from the question of fact. When the seller exhibits a sample purporting to be drawn from an existing bulk, good faith of course requires that the sample be fairly drawn. But in mercantile experience the mere exhibition of a "sample" does not of itself show whether it is merely intended to "suggest" or to "be" the character of the subject-matter of the contract. The question is whether the seller has so acted with reference to the sample as to make him responsible that the whole shall have at least the values shown by it. The circumstances aid in answering this question. If the sample has been drawn from an existing bulk, it must be regarded as de-

scribing values of the goods contracted for unless it is accompanied by an unmistakable denial of such responsibility. If, on the other hand, a model of merchandise not on hand is offered, the mercantile presumption that it has become a literal description of the subject matter is not so strong, and particularly so if modification on the buyer's initiative impairs any feature of the model.

7. The precise time when words of description or affirmation are made or samples are shown is not material. The sole question is whether the language or samples or models are fairly to be regarded as part of the contract. If language is used after the closing of the deal (as when the buyer when taking delivery asks and receives an additional assurance), the warranty becomes a modification, and need not be supported by consideration if it is otherwise reasonable and in order (Section 2—209).

8. Concerning affirmations of value or a seller's opinion or commendation under subsection (2), the basic question remains the same: What statements of the seller have in the circumstances and in objec-

tive judgment become part of the basis of the bargain? As indicated above, all of the statements of the seller do so unless good reason is shown to the contrary. The provisions of subsection (2) are included, however, since common experience discloses that some statements or predictions cannot fairly be viewed as entering into the bargain. Even as to false statements of value, however, the possibility is left open that a remedy may be provided by the law relating to fraud or misrepresentation.

#### Cross references:

Point 1: Section 2—316.

Point 2: Sections 1—102(3) and 2—318.

Point 3: Section 2—316(2) (b).

Point 4: Section 2—316.

Point 5: Sections 1—205(4) and 2—314.

Point 6: Section 2—316.

Point 7: Section 2—209.

Point 8: Section 1—103.

#### Definitional cross references:

"Buyer". Section 2—103.

"Conforming". Section 2—106.

"Goods". Section 2—105.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

*Subsection (1) (a)* accords with North Carolina's prior definition of express warranty. See *Wrenn v. Morgan*, 148 N.C. 101, 61 S.E. 641 (1908); *Hodges v. Smith*, 158 N.C. 256, 73 S.E. 807 (1912); *Swift & Co. v. Meekins*, 179 N.C. 173, 102 S.E. 138 (1920); *Potter v. National Supply Co.*, 230 N.C. 1, 51 S.E.2d 908 (1949).

*Subsection (1) (b)* stating a warranty where a sale is by description accords with *Swift & Co. v. Aydlett*, 192 N.C. 330, 135

S.E. 141 (1926), and *Lexington Grocery Co. v. Vernoy*, 167 N.C. 427, 83 S.E. 567 (1914).

*Subsection (1) (c)* accords with *Woodridge v. Brown*, 149 N.C. 299, 62 S.E. 1076 (1908); *Robertson v. Halton*, 156 N.C. 215, 72 S.E. 316 (1911); *Kime v. Riddle*, 174 N.C. 442, 93 S.E. 946 (1917); *Wrenn v. Morgan*, 148 N.C. 101, 61 S.E. 641 (1908).

There will be no change in North Carolina law in connection with this section.

### § 25-2-314. Implied warranty: Merchantability; usage of trade.—

(1) Unless excluded or modified (§ 25-2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the contract description; and

(b) in the case of fungible goods, are of fair average quality within the description; and

(c) are fit for the ordinary purposes for which such goods are used; and

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (§ 25-2-316) other implied warranties may arise from course of dealing or usage of trade. (1965, c. 700, s. 1.)



## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 15(2), Uniform Sales Act.

**Changes:** Completely rewritten.

**Purposes of changes:** This section, drawn in view of the steadily developing case law on the subject, is intended to make it clear that:

1. The seller's obligation applies to present sales as well as to contracts to sell subject to the effects of any examination of specific goods. (Subsection (2) of Section 2—316). Also, the warranty of merchantability applies to sales for use as well as to sales for resale.

2. The question when the warranty is imposed turns basically on the meaning of the terms of the agreement as recognized in the trade. Goods delivered under an agreement made by a merchant in a given line of trade must be of a quality comparable to that generally acceptable in that line of trade under the description or other designation of the goods used in the agreement. The responsibility imposed rests on any merchant-seller, and the absence of the words "grower or manufacturer or not" which appeared in Section 15(2) of the Uniform Sales Act does not restrict the applicability of this section.

3. A specific designation of goods by the buyer does not exclude the seller's obligation that they be fit for the general purposes appropriate to such goods. A contract for the sale of second-hand goods, however, involves only such obligation as is appropriate to such goods for that is their contract description. A person making an isolated sale of goods is not a "merchant" within the meaning of the full scope of this section and, thus, no warranty of merchantability would apply. His knowledge of any defects not apparent on inspection would, however, without need for express agreement and in keeping with the underlying reason of the present section and the provisions on good faith, impose an obligation that known material but hidden defects be fully disclosed.

4. Although a seller may not be a "merchant" as to the goods in question, if he states generally that they are "guaranteed" the provisions of this section may furnish a guide to the content of the resulting express warranty. This has particular significance in the case of second-hand sales, and has further significance in limiting the effect of fine-print disclaimer clauses where their effect would be inconsistent with large-print assertions of "guarantee".

5. The second sentence of subsection (1) covers the warranty with respect to food and drink. Serving food or drink for value is a sale, whether to be consumed on the premises or elsewhere. Cases to the contrary are rejected. The principal warranty is that stated in subsections (1) and (2) (c) of this section.

6. Subsection (2) does not purport to exhaust the meaning of "merchantable" nor to negate any of its attributes not specifically mentioned in the text of the statute, but arising by usage of trade or through case law. The language used is "must be at least such as . . ." and the intention is to leave open other possible attributes of merchantability.

7. Paragraphs (a) and (b) of subsection (2) are to be read together. Both refer, as indicated above, to the standards of that line of the trade which fits the transaction and the seller's business. "Fair average" is a term directly appropriate to agricultural bulk products and means goods centering around the middle belt of quality, not the least or the worst that can be understood in the particular trade by the designation, but such as can pass "without objection." Of course a fair percentage of the least is permissible but the goods are not "fair average" if they are all of the least or worst quality possible under the description. In cases of doubt as to what quality is intended, the price at which a merchant closes a contract is an excellent index of the nature and scope of his obligation under the present section.

8. Fitness for the ordinary purposes for which goods of the type are used is a fundamental concept of the present section and is covered in paragraph (c). As stated above, merchantability is also a part of the obligation owing to the purchaser for use. Correspondingly, protection, under this aspect of the warranty, of the person buying for resale to the ultimate consumer is equally necessary and merchantable goods must therefore be "honestly" resalable in the normal course of business because they are what they purport to be.

9. Paragraph (d) on evenness of kind, quality and quantity follows case law. But precautionary language has been added as a reminder of the frequent usages of trade which permit substantial variations both with and without an allowance or an obligation to replace the varying units.

10. Paragraph (e) applies only where the nature of the goods and of the transaction requires a certain type of container,

package or label. Paragraph (f) applies, on the other hand, wherever there is a label or container on which representations are made, even though the original contract, either by express terms or usage of trade, may not have required either the labelling or the representation. This follows from the general obligation of good faith which requires that a buyer should not be placed in the position of reselling or using goods delivered under false representations appearing on the package or container. No problem of extra consideration arises in this connection since, under this Article, an obligation is imposed by the original contract not to deliver mislabeled articles, and the obligation is imposed where mercantile good faith so requires and without reference to the doctrine of consideration.

11. Exclusion or modification of the warranty of merchantability, or of any part of it, is dealt with in the section to which the text of the present section makes explicit precautionary references. That section must be read with particular reference to its subsection (4) on limitation of remedies. The warranty of merchantability, wherever it is normal, is so commonly taken for granted that its exclusion from the contract is a matter threatening surprise and therefore requiring special precaution.

12. Subsection (3) is to make explicit that usage of trade and course of dealing can create warranties and that they are implied rather than express warranties and thus subject to exclusion or modification under Section 2-316. A typical in-

stance would be the obligation to provide pedigree papers to evidence conformity of the animal to the contract in the case of a pedigreed dog or blooded bull.

13. In an action based on breach of warranty, it is of course necessary to show not only the existence of the warranty but the fact that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained. In such an action an affirmative showing by the seller that the loss resulted from some action or event following his own delivery of the goods can operate as a defense. Equally, evidence indicating that the seller exercised care in the manufacture, processing or selection of the goods is relevant to the issue of whether the warranty was in fact broken. Action by the buyer following an examination of the goods which ought to have indicated the defect complained of can be shown as matter bearing on whether the breach itself was the cause of the injury.

#### Cross references:

Point 1: Section 2-316.

Point 3: Sections 1-203 and 2-104.

Point 5: Section 2-315.

Point 11: Section 2-316.

Point 12: Sections 1-201, 1-205 and 2-316.

#### Definitional cross references:

"Agreement". Section 1-201.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Merchant". Section 2-104.

"Goods". Section 2-105.

"Seller". Section 2-103.

### NORTH CAROLINA COMMENT

*Subsection (1):* The first sentence of subsection (1), implying warranty of merchantability that personal property is merchantable and reasonably fit for the purposes for which sold, accords with prior North Carolina law. See *Aldridge Motors v. Alexander*, 217 N.C. 750, 9 S.E.2d 469 (1940); *Swift & Co. v. Aydtlett*, 192 N.C. 330, 135 S.E. 141 (1926); *Continental Jewelry Co. v. Stanfield*, 183 N.C. 10, 110 S.E. 585 (1922); *Ashford v. H. C. Shrader Co.*, 167 N.C. 45, 83 S.E. 29 (1914); *Shoop Family Medicine Co. v. Davenport*, 163 N.C. 294, 79 S.E. 602 (1913).

The second sentence of subsection (1) negates the possibility of argument that a restaurateur merely "utters a service" and does not make a "sale." This argument had been upheld in a bulk sales case in *Swift & Co. v. Tempelos*, 178 N.C. 487, 101 S.E. 8 (1919), but expressly was not decided in *Williams v. Elson*, 218 N.C. 157, 10 S.E.2d

668 (1940), in a food warranty case. The UCC makes restaurants liable for "sales" whether the food served is to be consumed on or off the premises. It clarifies a point that may have been questionable under prior law. This can be quite important in North Carolina because of the practical nonavailability of the doctrine of *res ipsa loquitur* in negligence actions, often necessitating resort to warranty actions when proof of negligence is not available.

*Subsection (2)* accords with prior North Carolina law in general but spells out in detail the requirements of "merchantability." North Carolina's definition of merchantability under prior law is set out in *Swift & Co. v. Aydtlett*, 192 N.C. 330, 135 S.E. 141 (1926): "A vendor of an article of personal property, by name and description, cannot relieve himself of the obligation arising from the warranty implied by law to deliver an article which is at

least merchantable, or saleable or fit for the use of which articles of that name and description are ordinarily sold and bought."

Note that the section only applies when the seller is a merchant.

**§ 25-2-315. Implied warranty: Fitness for particular purpose.**—Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section [§ 25-2-316] an implied warranty that the goods shall be fit for such purpose. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 15 (1), (4), (5), Uniform Sales Act.  
**Changes:** Rewritten.

##### Purposes of changes:

1. Whether or not this warranty arises in any individual case is basically a question of fact to be determined by the circumstances of the contracting. Under this section the buyer need not bring home to the seller actual knowledge of the particular purpose for which the goods are intended or of his reliance on the seller's skill and judgment, if the circumstances are such that the seller has reason to realize the purpose intended or that the reliance exists. The buyer, of course, must actually be relying on the seller.

2. A "particular purpose" differs from the ordinary purpose for which the goods are used in that it envisages a specific use by the buyer which is peculiar to the nature of his business whereas the ordinary purposes for which goods are used are those envisaged in the concept of merchantability and go to uses which are customarily made of the goods in question. For example, shoes are generally used for the purpose of walking upon ordinary ground, but a seller may know that a particular pair was selected to be used for climbing mountains.

A contract may of course include both a warranty of merchantability and one of fitness for a particular purpose.

The provisions of this Article on the cumulation and conflict of express and implied warranties must be considered on the question of inconsistency between or among warranties. In such a case any question of fact as to which warranty was intended by the parties to apply must be resolved in favor of the warranty of fitness for particular purpose as against all other warranties except where the buyer has taken upon himself the responsibility of furnishing the technical specifications.

3. In connection with the warranty of fitness for a particular purpose the provisions of this Article on the allocation or

division of risks are particularly applicable in any transaction in which the purpose for which the goods are to be used combines requirements both as to the quality of the goods themselves and compliance with certain laws or regulations. How the risks are divided is a question of fact to be determined, where not expressly contained in the agreement, from the circumstances of contracting, usage of trade, course of performance and the like, matters which may constitute the "otherwise agreement" of the parties by which they may divide the risk or burden.

4. The absence from this section of the language used in the Uniform Sales Act in referring to the seller, "whether he be the grower or manufacturer or not," is not intended to impose any requirement that the seller be a grower or manufacturer. Although normally the warranty will arise only where the seller is a merchant with the appropriate "skill or judgment," it can arise as to non-merchants where this is justified by the particular circumstances.

5. The elimination of the "patent or other trade name" exception constitutes the major extension of the warranty of fitness which has been made by the cases and continued in this Article. Under the present section the existence of a patent or other trade name and the designation of the article by that name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the buyer actually relied on the seller, but it is not of itself decisive of the issue. If the buyer himself is insisting on a particular brand he is not relying on the seller's skill and judgment and so no warranty results. But the mere fact that the article purchased has a particular patent or trade name is not sufficient to indicate nonreliance if the article has been recommended by the seller as adequate for the buyer's purposes.

6. The specific reference forward in the present section to the following section on exclusion or modification of warranties is



to call attention to the possibility of eliminating the warranty in any given case. However, it must be noted that under the following section the warranty of fitness for a particular purpose must be excluded or modified by a conspicuous writing.

**Cross references:**

Point 2: Sections 2—314 and 2—317.

Point 3: Section 2—303.

Point 6: Section 2—316.

**Definitional cross references:**

"Buyer". Section 2—103.

"Goods". Section 2—105.

"Seller". Section 2—103.

**NORTH CAROLINA COMMENT**

This section accords with *Stokes v. Edwards*, 230 N.C. 306, 52 S.E.2d 797 (1949); *Southern Box & Lumber Co. v. Home*

*Chair Co.*, 250 N.C. 71, 108 S.E.2d 70 (1959).

§ 25-2-316. **Exclusion or modification of warranties.**—(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this article on parol or extrinsic evidence (§ 25-2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this article on liquidation or limitation of damages and on contractual modification of remedy (§§ 25-2-718 and 25-2-719). (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.  
**Purposes:**

1. This section is designed principally to deal with those frequent clauses in sales contracts which seek to exclude "all warranties, express or implied." It seeks to protect a buyer from unexpected and unbargained language of disclaimer by denying effect to such language when inconsistent with language of express warranty and permitting the exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise.

2. The seller is protected under this Article against false allegations of oral warranties by its provisions on parol and extrinsic evidence and against unauthorized representations by the customary

"lack of authority" clauses. This Article treats the limitation or avoidance of consequential damages as a matter of limiting remedies for breach, separate from the matter of creation of liability under a warranty. If no warranty exists, there is of course no problem of limiting remedies for breach of warranty. Under subsection (4) the question of limitation of remedy is governed by the sections referred to rather than by this section.

3. Disclaimer of the implied warranty of merchantability is permitted under subsection (2), but with the safeguard that such disclaimers must mention merchantability and in case of a writing must be conspicuous.

4. Unlike the implied warranty of merchantability, implied warranties of fitness

for a particular purpose may be excluded by general language, but only if it is in writing and conspicuous.

5. Subsection (2) presupposes that the implied warranty in question exists unless excluded or modified. Whether or not language of disclaimer satisfies the requirements of this section, such language may be relevant under other sections to the question whether the warranty was ever in fact created. Thus, unless the provisions of this Article on parol and extrinsic evidence prevent, oral language of disclaimer may raise issues of fact as to whether reliance by the buyer occurred and whether the seller had "reason to know" under the section on implied warranty of fitness for a particular purpose.

6. The exceptions to the general rule set forth in paragraphs (a), (b) and (c) of subsection (3) are common factual situations in which the circumstances surrounding the transaction are in themselves sufficient to call the buyer's attention to the fact that no implied warranties are made or that a certain implied warranty is being excluded.

7. Paragraph (a) of subsection (3) deals with general terms such as "as is," "as they stand," "with all faults," and the like. Such terms in ordinary commercial usage are understood to mean that the buyer takes the entire risk as to the quality of the goods involved. The terms covered by paragraph (a) are in fact merely a particularization of paragraph (c) which provides for exclusion or modification of implied warranties by usage of trade.

8. Under paragraph (b) of subsection (3) warranties may be excluded or modified by the circumstances where the buyer examines the goods or a sample or model of them before entering into the contract. "Examination" as used in this paragraph is not synonymous with inspection before acceptance or at any other time after the contract has been made. It goes rather to the nature of the responsibility assumed by the seller at the time of the making of the contract. Of course if the buyer discovers the defect and uses the goods anyway, or if he unreasonably fails to examine the goods before he uses them, resulting injuries may be found to result from his own action rather than proximately from a breach of warranty. See Sections 2-314 and 2-715 and comments thereto.

In order to bring the transaction within the scope of "refused to examine" in paragraph (b), it is not sufficient that the goods are available for inspection.

There must in addition be a demand by the seller that the buyer examine the goods fully. The seller by the demand puts the buyer on notice that he is assuming the risk of defects which the examination ought to reveal. The language "refused to examine" in this paragraph is intended to make clear the necessity for such demand.

Application of the doctrine of "caveat emptor" in all cases where the buyer examines the goods regardless of statements made by the seller is, however, rejected by this Article. Thus, if the offer of examination is accompanied by words as to their merchantability or specific attributes and the buyer indicates clearly that he is relying on those words rather than on his examination, they give rise to an "express" warranty. In such cases the question is one of fact as to whether a warranty of merchantability has been expressly incorporated in the agreement. Disclaimer of such an express warranty is governed by subsection (1) of the present section.

The particular buyer's skill and the normal method of examining goods in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious cannot excuse the buyer. However, an examination under circumstances which do not permit chemical or other testing of the goods would not exclude defects which could be ascertained only by such testing. Nor can latent defects be excluded by a simple examination. A professional buyer examining a product in his field will be held to have assumed the risk as to all defects which a professional in the field ought to observe, while a nonprofessional buyer will be held to have assumed the risk only for such defects as a layman might be expected to observe.

9. The situation in which the buyer gives precise and complete specifications to the seller is not explicitly covered in this section, but this is a frequent circumstance by which the implied warranties may be excluded. The warranty of fitness for a particular purpose would not normally arise since in such a situation there is usually no reliance on the seller by the buyer. The warranty of merchantability in such a transaction, however, must be considered in connection with the next section on the cumulation and conflict of warranties. Under paragraph (c) of that section in case of such an inconsistency the implied warranty of merchantability is displaced by the express warranty that

the goods will comply with the specifications. Thus, where the buyer gives detailed specifications as to the goods, neither of the implied warranties as to quality will normally apply to the transaction unless consistent with the specifications.

**Cross references:**

Point 2: Sections 2—202, 2—718 and 2—719.

Point 7: Sections 1—205 and 2—208.

**Definitional cross references:**

"Agreement". Section 1—201.

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Course of dealing". Section 1—205.

"Goods". Section 2—105.

"Remedy". Section 1—201.

"Seller". Section 2—103.

"Usage of trade". Section 1—205.

### NORTH CAROLINA COMMENT

*Subsection (1)* seems to accord with *Case Threshing Mach. Co. v. McClamrock*, 152 N.C. 405, 67 S.E. 991 (1910), that personal property may be sold with or without warranty if there is an express stipulation that the property is not warranted. See also *Swift & Co. v. Etheridge*, 190 N.C. 162, 129 S.E. 453 (1925). The intent to warrant is a matter which must appear in the form of the expression, aided in proper cases by the circumstances surrounding the transaction. *Walston v. R. B. Whitley & Co.*, 226 N.C. 537, 39 S.E.2d 375 (1946). The whole contract should be examined.

*Subsection (2)* treats a subject that was cloaked in uncertainty in North Carolina. Could implied warranties be disclaimed by the seller? If so, what terms of disclaimer were required?

In *Swift & Co. v. Etheridge*, 190 N.C. 162, 129 S.E. 453 (1925), the seller sold goods and the instrument evidencing the sale said "without warranty as to results of its use, or otherwise." It was contended that this disclaimer negated all implied as well as express warranties. The court held the implied warranty "that the goods sold and delivered were merchantable, or salable, and fit for the purpose for which they were bought" was not effectively disclaimed or negated. See *Hall Furniture Co. v. Crane Mfg. Co.*, 169 N.C. 41, 85 S.E. 35 (1915).

Yet, in *Primrose Petroleum Co. v. Allen*, 219 N.C. 461, 14 S.E.2d 402 (1941), where a special express warranty limited the liability of the seller to those express warranties stated in the special warranty, the court held that all other warranties ordinarily implied in sales contracts were excluded.

The UCC, by this section, attempts to

spell out and to render certain a determination of when implied warranties have been effectively disclaimed. After having defined the implied warranty of merchantability, it states that to exclude this warranty, the disclaimer must mention merchantability and must be conspicuous. To disclaim the implied warranty of fitness, the exclusion must be by a writing and conspicuous.

*Subsection (3) (a)* allows all implied warranties to be excluded by "as is" or "with all faults" provisions that are clear to the buyer. This subsection accords with general commercial understanding.

*Subsection (3) (b)* accords with *Driver v. Snow*, 245 N.C. 223, 95 S.E.2d 519 (1956); *Southern Box & Lumber Co. v. Home Chair Co.*, 250 N.C. 71, 108 S.E.2d 70 (1959): "There is no implied warranty where the buyer has knowledge equal to that of the seller . . . the presence of the goods at the time of the sale open and available for inspection . . . prevents the implication of warranties."

*Subsection (3) (c)* applies to nonmerchants and evinces what is left of the doctrine of caveat emptor.

*Subsection (3) (c)* has no apparent parallel in prior North Carolina law.

*Subsection (4)*: See North Carolina Comments in connection with GS 25-2-718 and 25-2-719 for a discussion of the principles that govern subsection (4) of this section. See especially *Allen v. Tompkins*, 136 N.C. 208, 48 S.E. 655 (1904), that warranty provisions to a contract can limit liability to the making of repairs or the replacement of other goods in lieu of damages. See also *Charles Hackley Piano Co. v. Kennedy*, 152 N.C. 196, 67 S.E. 488 (1910).

**§ 25-2-317. Cumulation and conflict of warranties express or implied.**—Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:



(a) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) A sample from an existing bulk displaces inconsistent general language of description.

(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** On cumulation of warranties see Sections 14, 15, and 16, Uniform Sales Act.

**Changes:** Completely rewritten into one section.

##### Purposes of changes:

1. The present section rests on the basic policy of this Article that no warranty is created except by some conduct (either affirmative action or failure to disclose) on the part of the seller. Therefore, all warranties are made cumulative unless this construction of the contract is impossible or unreasonable.

This Article thus follows the general policy of the Uniform Sales Act except that in case of the sale of an article by its patent or trade name the elimination of the warranty of fitness depends solely on whether the buyer has relied on the seller's skill and judgment; the use of the patent or trade name is but one factor in making this determination.

2. The rules of this section are designed to aid in determining the intention of the parties as to which of inconsistent warranties which have arisen from the cir-

cumstances of their transaction shall prevail. These rules of intention are to be applied only where factors making for an equitable estoppel of the seller do not exist and where he has in perfect good faith made warranties which later turn out to be inconsistent. To the extent that the seller has led the buyer to believe that all of the warranties can be performed, he is estopped from setting up any essential inconsistency as a defense.

3. The rules in subsections (a), (b) and (c) are designed to ascertain the intention of the parties by reference to the factor which probably claimed the attention of the parties in the first instance. These rules are not absolute but may be changed by evidence showing that the conditions which existed at the time of contracting make the construction called for by the section inconsistent or unreasonable.

##### Cross reference:

Point 1: Section 2—315.

##### Definitional cross reference:

"Party". Section 1—201.

#### NORTH CAROLINA COMMENT

The first sentence of this section establishes the rule of construction that warranties, both express and implied, shall be construed as consistent unless such construction is unreasonable or contrary to the intention of the parties.

The first sentence also makes all warranties cumulative if consistent. This seems to conflict with *Charles Hackley Piano Co. v. Kennedy*, 152 N.C. 196, 67 S.E. 488 (1910); *Farquhar Co. v. Hardy Hardware Co.*, 174 N.C. 369, 93 S.E. 922 (1917); *Case Threshing Mach. Co. v. McClamrock*, 152 N.C. 405, 67 S.E. 991 (1910); *Armour Fertilizer Works v. Aiken*, 175 N.C. 398, 95 S.E. 657 (1918), that an express warranty excludes an implied warranty as to closely related subjects or qualities in a thing sold. In other words, in North Carolina if there was an express warranty in connection with a matter, there was no implied warranty in connection with that matter which

could coexist. Warranties were not cumulative, at least in all cases, in North Carolina. But see *Hyman v. Broughton*, 197 N.C. 1, 147 S.E. 434 (1929), that they were cumulative if they related to different matters.

Paragraph (a) is consistent with *Pickrell & Craig Co. v. Wilson Wholesale Co.*, 169 N.C. 381, 86 S.E. 187 (1915), that every sale where a sample is shown is not a sale by sample where there are other exact or technical descriptive specifications. The intention of the parties governs.

There is no exact parallel to paragraph (b) but that subsection merely says that a specific description by sample will displace a description by general language.

Paragraph (c) changes prior North Carolina law. There was no implied warranty of fitness of purpose if there was an express warranty of quality. *Hyman v. Broughton*, 197 N.C. 1, 147 S.E. 434 (1929).

**§ 25-2-318. Third party beneficiaries of warranties express or implied.**—A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his

home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. The last sentence of this section does not mean that a seller is precluded from excluding or disclaiming a warranty which might otherwise arise in connection with the sale provided such exclusion or modification is permitted by Section 2—316. Nor does that sentence preclude the seller from limiting the remedies of his own buyer and of any beneficiaries, in any manner provided in Sections 2—718 or 2—719. To the extent that the contract of sale contains provisions under which warranties are excluded or modified, or remedies for breach are limited, such provisions are equally operative against beneficiaries of warranties under this section. What this last sentence forbids is exclusion of liability by the seller to the persons to whom the warranties which he has made to his buyer would extend under this section.

2. The purpose of this section is to give the buyer's family, household and guests the benefit of the same warranty which the buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to "privity." It seeks to accom-

plish this purpose without any derogation of any right or remedy resting on negligence. It rests primarily upon the merchant-seller's warranty under this Article that the goods sold are merchantable and fit for the ordinary purposes for which such goods are used rather than the warranty of fitness for a particular purpose. Implicit in the section is that any beneficiary of a warranty may bring a direct action for breach of warranty against the seller whose warranty extends to him.

3. This section expressly includes as beneficiaries within its provisions the family, household, and guests of the purchaser. Beyond this, the section is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain.

#### Cross references:

Point 1: Sections 2—316, 2—718 and 2—719.

Point 2: Section 2—314.

#### Definitional cross references:

"Buyer". Section 2—103.

"Goods". Section 2—105.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

North Carolina, in the absence of a warranty expressly directed to an ultimate consumer, required privity of contract between the parties to a warranty action before recovery was allowed. *Wyatt v. North Carolina Equip. Co.*, 253 N.C. 355, 117 S.E.2d 21 (1960); *Prince v. Smith*, 254 N.C. 768, 119 S.E.2d 923 (1961). A warranting seller was liable only to the immediate buyer with whom there is a contractual relation. An employee of the buyer could not sue on the seller's warranty as the employee was a stranger to the contract. A purchaser from a retailer could not sue a manufacturer of defective goods with whom he has no contractual relation for breach of warranty. See *Thomason v. Ballard & Ballard Co.*, 208 N.C. 1, 179 S.E. 30 (1935).

In such cases, the purchaser had to sue his immediate seller and in turn his immediate seller might sue his supplier and his supplier might ultimately reach the manufacturer. *Prince v. Smith*, 254 N.C. 768, 119 S.E.2d 923 (1961). But there could be no direct suit by an ultimate purchaser or consumer against a manufacturer or remote

seller unless he had made an express warranty intended to attach to an item sold and intended to run to the ultimate consumer. See *Simpson v. American Oil Co.*, 217 N.C. 542, 8 S.E.2d 813 (1940), to the effect that a warranty can be so stated that it will run from a manufacturer to an ultimate consumer.

Therefore, in North Carolina, if a mother purchased a product for consumption by her children or by a guest, if the product injured or poisoned her child or guest, the mother-purchaser only had an action for *her* damages due to breach of the retailer's warranty. *No one* had an action for breach of warranty against any wholesaler, jobber or manufacturer of the product as there was not the requisite privity.

Nor was the theory that a negligence action was permitted an adequate solution, especially in North Carolina, where the doctrine of *res ipsa loquitur* is not applicable to any appreciable degree. See *Enloe v. Charlotte Coca-Cola Bottling Co.*, 208 N.C. 305, 180 S.E. 582 (1935), and cases there cited. Evidence of negligence other

than mere injury from a product must be established.

The damages for the child's own injury or the damages for the guest's own injury would likely not be recovered by any method in North Carolina. Recovery on warranty was not allowed because of lack of privity; recovery on negligence would not likely be available, either from lack of any negligence, or because of difficulty of proof, especially in light of North Carolina's law on *res ipsa loquitur*.

The UCC provision allows the seller's warranty, express or implied, to run to persons other than the immediate buyer who are in the family or household of the buyer or who is a guest of the buyer, if it is reasonable that these persons should use or consume or be affected by the goods.

The UCC does away with the doctrine of privity in extending coverage of warranty to a buyer's family, household and guests. The UCC does *not* abolish North Carolina's requirement of privity with reference to strangers to the contract such as employees. See *Wyatt v. North Carolina Equip. Co.*, 253 N.C. 355, 117 S.E.2d 21 (1960). Nor does it affect the requirement of privity that prevents a cause of action by any ultimate consumer or buyer against a remote seller or manufacturer. See *Thomason v. Ballard & Ballard Co.*, 208 N.C. 1, 179 S.E. 30 (1935); *Perfecting Serv. Co. v. Product Dev. & Sales Co.*, 261 N.C. 660, 136 S.E.2d 56 (1964); *Murray v. Benson Aircraft Corp.*, 259 N.C. 638, 131 S.E.2d 367 (1963); *Prince v. Smith*, 254 N.C. 768, 119 S.E.2d 923 (1961).

**§ 25-2-319. F.O.B. and F.A.S. terms.**—(1) Unless otherwise agreed the term F.O.B. (which means "free on board") at a named place, even though used only in connection with the stated price, is a delivery term under which

(a) when the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this article (§ 25-2-504) and bear the expense and risk of putting them into the possession of the carrier; or

(b) when the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this article (§ 25-2-503);

(c) when under either (a) or (b) the term is also F.O.B. vessel, car or other vehicle, the seller must in addition at his own expense and risk load the goods on board. If the term is F.O.B. vessel the buyer must name the vessel and in an appropriate case the seller must comply with the provisions of this article on the form of bill of lading (§ 25-2-323).

(2) Unless otherwise agreed the term F.A.S. vessel (which means "free alongside") at a named port, even though used only in connection with the stated price, is a delivery term under which the seller must

(a) at his own expense and risk deliver the goods alongside the vessel in the manner usual in that port or on a dock designated and provided by the buyer; and

(b) obtain and tender a receipt for the goods in exchange for which the carrier is under a duty to issue a bill of lading.

(3) Unless otherwise agreed in any case falling within subsection (1)(a) or (c) or subsection (2) the buyer must seasonably give any needed instructions for making delivery, including when the term is F.A.S. or F.O.B. the loading berth of the vessel and in an appropriate case its name and sailing date. The seller may treat the failure of needed instructions as a failure of cooperation under this article (§ 25-2-311). He may also at his option move the goods in any reasonable manner preparatory to delivery or shipment.

(4) Under the term F.O.B. vessel or F.A.S. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. This section is intended to negate the uncommercial line of decision which treats an "F.O.B." term as "merely a price term." The distinctions taken in

subsection (1) handle most of the issues which have on occasion led to the unfortunate judicial language just referred to. Other matters which have led to sound results being based on unhappy language in regard to F.O.B. clauses are dealt



with in this Act by Section 2—311(2) (seller's option re arrangements relating to shipment) and Sections 2—614 and 615 (substituted performance and seller's excuse).

2. Subsection (1) (c) not only specifies the duties of a seller who engages to deliver "F.O.B. vessel," or the like, but ought to make clear that no agreement is soundly drawn when it looks to reshipment from San Francisco or New York, but speaks merely of "F.O.B." the place.

3. The buyer's obligations stated in subsection (1) (c) and subsection (3) are, as shown in the text, obligations of cooperation. The last sentence of subsection (3) expressly, though perhaps unnecessarily, authorizes the seller, pending instructions, to go ahead with such preparatory moves as shipment from the interior to the named point of delivery. The sentence presupposes the usual case in which instructions "fail"; a prior repudiation by the buyer, giving notice that breach was intended, would remove the reason for the sentence, and would normally bring

into play, instead, the second sentence of Section 2—704, which duly calls for lessening damages.

4. The treatment of "F.O.B. vessel" in conjunction with F.A.S. fits, in regard to the need for payment against documents, with standard practice and case law; but "F.O.B. vessel" is a term which by its very language makes express the need for an "on board" document. In this respect, that term is stricter than the ordinary overseas "shipment" contract (C.I.F., etc., Section 2—320).

#### Cross references:

Sections 2—311(3), 2—323, 2—503 and 2—504.

#### Definitional cross references:

"Agreed". Section 1—201.

"Bill of lading". Section 1—201.

"Buyer". Section 2—103.

"Goods". Section 2—105.

"Seasonably". Section 1—204.

"Seller". Section 2—103.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

Subsections (1) (a) and (b) are in accord with prior North Carolina law as to F.O.B. shipments. See *Peed v. Burleson's, Inc.*, 244 N.C. 437, 94 S.E.2d 351 (1956): "Where the contract of sale provides for a sale F.O.B. the point of shipment, the title is generally held to pass, in the absence of a contrary intention between the parties, at the time of the delivery of the goods for shipment at the point designated . . . . If the seller by his contract undertakes to make the delivery himself at the point of destination, thus assuming the risk in

the carriage, the delivery to a carrier is not a delivery to the buyer." See also *Acme Paper Box Factory v. Atlantic Coast Line R.R.*, 148 N.C. 421, 62 S.E. 557 (1908). That this rule could be changed according to the intention of the parties, see *Gulf Ref. Co. v. Charlotte Constr. Co.*, 157 N.C. 277, 72 S.E. 1003 (1911).

The remainder of GS 25-2-319 is new in North Carolina, and the detailed obligations set out under F.O.B. and F.A.S. contracts fill gaps not treated in decisional law.

**§ 25-2-320. C.I.F. and C. & F. terms.**—(1) The term C.I.F. means that the price includes in a lump sum the cost of the goods and the insurance and freight to the named destination. The term C. & F. or C.F. means that the price so includes cost and freight to the named destination.

(2) Unless otherwise agreed and even though used only in connection with the stated price and destination, the term C.I.F. destination or its equivalent requires the seller at his own expense and risk to

(a) put the goods into the possession of a carrier at the port for shipment and obtain a negotiable bill or bills of lading covering the entire transportation to the named destination; and

(b) load the goods and obtain a receipt from the carrier (which may be contained in the bill of lading) showing that the freight has been paid or provided for; and

(c) obtain a policy or certificate of insurance, including any war risk insurance, of a kind and on terms then current at the port of shipment in the usual amount, in the currency of the contract, shown to cover the same goods covered by the bill of lading and providing for payment of loss to the order of the buyer or for the account of whom it may concern; but the seller may add to the price the amount of the premium for any such war risk insurance; and

(d) prepare an invoice of the goods and procure any other documents required to effect shipment or to comply with the contract ; and

(e) forward and tender with commercial promptness all the documents in due form and with any indorsement necessary to perfect the buyer's rights.

(3) Unless otherwise agreed the term C. & F. or its equivalent has the same effect and imposes upon the seller the same obligations and risks as a C.I.F. term except the obligation as to insurance.

(4) Under the term C.I.F. or C. & F. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** To make it clear that:

1. The C.I.F. contract is not a destination but a shipment contract with risk of subsequent loss or damage to the goods passing to the buyer upon shipment if the seller has properly performed all his obligations with respect to the goods. Delivery to the carrier is delivery to the buyer for purposes of risk and "title". Delivery of possession of the goods is accomplished by delivery of the bill of lading, and upon tender of the required documents the buyer must pay the agreed price without awaiting the arrival of the goods and if they have been lost or damaged after proper shipment he must seek his remedy against the carrier or insurer. The buyer has no right of inspection prior to payment or acceptance of the documents.

2. The seller's obligations remain the same even though the C.I.F. term is "used only in connection with the stated price and destination".

3. The insurance stipulated by the C.I.F. term is for the buyer's benefit, to protect him against the risk of loss or damage to the goods in transit. A clause in a C.I.F. contract "insurance—for the account of sellers" should be viewed in its ordinary mercantile meaning that the sellers must pay for the insurance and not that it is intended to run to the seller's benefit.

4. A bill of lading covering the entire transportation from the port of shipment is explicitly required but the provision on this point must be read in the light of its reason to assure the buyer of as full protection as the conditions of shipment reasonably permit, remembering always that this type of contract is designed to move the goods in the channels commercially available. To enable the buyer to deal with the goods while they are afloat the bill of lading must be one that covers only the quantity of goods called for by the contract. The buyer is not re-

quired to accept his part of the goods without a bill of lading because the latter covers a larger quantity, nor is he required to accept a bill of lading for the whole quantity under a stipulation to hold the excess for the owner. Although the buyer is not compelled to accept either goods or documents under such circumstances he may of course claim his rights in any goods which have been identified to his contract.

5. The seller is given the option of paying or providing for the payment of freight. He has no option to ship "freight collect" unless the agreement so provides. The rule of the common law that the buyer need not pay the freight if the goods do not arrive is preserved.

Unless the shipment has been sent "freight collect" the buyer is entitled to receive documentary evidence that he is not obligated to pay the freight; the seller is therefore required to obtain a receipt "showing that the freight has been paid or provided for." The usual notation in the appropriate space on the bill of lading that the freight has been prepaid is a sufficient receipt, as at common law. The phrase "provided for" is intended to cover the frequent situation in which the carrier extends credit to a shipper for the freight on successive shipments and receives periodical payments of the accrued freight charges from him.

6. The requirement that unless otherwise agreed the seller must procure insurance "of a kind and on terms then current at the port for shipment in the usual amount, in the currency of the contract, sufficiently shown to cover the same goods covered by the bill of lading", applies to both marine and war risk insurance. As applied to marine insurance, it means such insurance as is usual or customary at the port for shipment with reference to the particular kind of goods involved, the character and equipment of the vessel, the route of the voyage, the port of destination and any other con-

siderations that affect the risk. It is the substantial equivalent of the ordinary insurance in the particular trade and on the particular voyage and is subject to agreed specifications of type or extent of coverage. The language does not mean that the insurance must be adequate to cover all risks to which the goods may be subject in transit. There are some types of loss or damage that are not covered by the usual marine insurance and are excepted in bills of lading or in applicable statutes from the causes of loss or damage for which the carrier or the vessel is liable. Such risks must be borne by the buyer under this Article.

Insurance secured in compliance with a C.I.F. term must cover the entire transportation of the goods to the named destination.

7. An additional obligation is imposed upon the seller in requiring him to procure customary war risk insurance at the buyer's expense. This changes the common law on the point. The seller is not required to assume the risk of including in the C.I.F. price the cost of such insurance, since it often fluctuates rapidly, but is required to treat it simply as a necessary for the buyer's account. What war risk insurance is "current" or usual turns on the standard forms of policy or rider in common use.

8. The C.I.F. contract calls for insurance covering the value of the goods at the time and place of shipment and does not include any increase in market value during transit or any anticipated profit to the buyer on a sale by him.

The contract contemplates that before the goods arrive at their destination they may be sold again and again on C.I.F. terms and that the original policy of insurance and bill of lading will run with the interest in the goods by being transferred to each successive buyer. A buyer who becomes the seller in such an intermediate contract for sale does not thereby, if his sub-buyer knows the circumstances, undertake to insure the goods again at an increased price fixed in the new contract or to cover the increase in price by additional insurance, and his buyer may not reject the documents on the ground that the original policy does not cover such higher price. If such a sub-buyer desires additional insurance he must procure it for himself.

Where the seller exercises an option to ship "freight collect" and to credit the buyer with the freight against the C.I.F. price, the insurance need not cover the freight since the freight is not at the

buyer's risk. On the other hand, where the seller prepays the freight upon shipping under a bill of lading requiring prepayment and providing that the freight shall be deemed earned and shall be retained by the carrier "ship and/or cargo lost or not lost," or using words of similar import, he must procure insurance that will cover the freight, because notwithstanding that the goods are lost in transit the buyer is bound to pay the freight as part of the C.I.F. price and will be unable to recover it back from the carrier.

9. Insurance "for the account of whom it may concern" is usual and sufficient. However, for a valid tender the policy of insurance must be one which can be disposed of together with the bill of lading and so must be "sufficiently shown to cover the same goods covered by the bill of lading." It must cover separately the quantity of goods called for by the buyer's contract and not merely insure his goods as part of a larger quantity in which others are interested, a case provided for in American mercantile practice by the use of negotiable certificates of insurance which are expressly authorized by this section. By usage these certificates are treated as the equivalent of separate policies and are good tender under C.I.F. contracts. The term "certificate of insurance", however, does not of itself include certificates or "cover notes" issued by the insurance broker and stating that the goods are covered by a policy. Their sufficiency as substitutes for policies will depend upon proof of an established usage or course of dealing. The present section rejects the English rule that not only brokers' certificates and "cover notes" but also certain forms of American insurance certificates are not the equivalent of policies and are not good tender under a C.I.F. contract.

The seller's failure to tender a proper insurance document is waived if the buyer refuses to make payment on other and untenable grounds at a time when proper insurance could have been obtained and tendered by the seller if timely objection had been made. Even a failure to insure on shipment may be cured by seasonable tender of a policy retroactive in effect; e. g., one insuring the goods "lost or not lost." The provisions of this Article on cure of improper tender and on waiver of buyer's objections by silence are applicable to insurance tenders under a C.I.F. term. Where there is no waiver by the buyer as described above, however, the fact



that the goods arrive safely does not cure the seller's breach of his obligations to insure them and tender to the buyer a proper insurance document.

10. The seller's invoice of the goods shipped under a C.I.F. contract is regarded as a usual and necessary document upon which reliance may properly be placed. It is the document which evidences points of description, quality and the like which do not readily appear in other documents. This Article rejects those statements to the effect that the invoice is a usual but not a necessary document under a C.I.F. term.

11. The buyer needs all of the documents required under a C.I.F. contract, in due form and with necessary endorsements, so that before the goods arrive he may deal with them by negotiating the documents or may obtain prompt possession of the goods after their arrival. If the goods are lost or damaged in transit the documents are necessary to enable him promptly to assert his remedy against the carrier or insurer. The seller is therefore obligated to do what is mercantilely reasonable in the circumstances and should make every reasonable exertion to send forward the documents as soon as possible after the shipment. The requirement that the documents be forwarded with "commercial promptness" expresses a more urgent need for action than that suggested by the phrase "reasonable time".

12. Under a C.I.F. contract the buyer, as under the common law, must pay the price upon tender of the required documents without first inspecting the goods, but his payment in these circumstances does not constitute an acceptance of the goods nor does it impair his right of subsequent inspection or his options and remedies in the case of improper delivery. All remedies and rights for the seller's breach are reserved to him. The buyer must pay before inspection and assert his remedy against the seller afterward unless the nonconformity of the goods amounts to a real failure of consideration, since the purpose of choosing this form of contract is to give the seller protection against the buyer's unjustifiable rejection of the goods at a distant port of destination which would necessitate taking possession of the goods and suing the buyer there.

13. A valid C.I.F. contract may be made which requires part of the transportation to be made on land and part on the sea, as where the goods are to be brought by rail from an inland point

to a seaport and thence transported by vessel to the named destination under a "through" or combination bill of lading issued by the railroad company. In such a case shipment by rail from the inland point within the contract period is a timely shipment notwithstanding that the loading of the goods on the vessel is delayed by causes beyond the seller's control.

14. Although subsection (2) stating the legal effects of the C.I.F. term is an "unless otherwise agreed" provision, the express language used in an agreement is frequently a precautionary, fuller statement of the normal C.I.F. terms and hence not intended as a departure or variation from them. Moreover, the dominant outlines of the C.I.F. term are so well understood commercially that any variation should, whenever reasonably possible, be read as falling within those dominant outlines rather than as destroying the whole meaning of a term which essentially indicates a contract for proper shipment rather than one for delivery at destination. Particularly careful consideration is necessary before a printed form or clause is construed to mean agreement otherwise and where a C.I.F. contract is prepared on a printed form designed for some other type of contract, the C.I.F. terms must prevail over printed clauses repugnant to them.

15. Under subsection (4) the fact that the seller knows at the time of the tender of the documents that the goods have been lost in transit does not affect his rights if he has performed his contractual obligations. Similarly, the seller cannot perform under a C.I.F. term by purchasing and tendering landed goods.

16. Under the C. & F. term, as under the C.I.F. term, title and risk of loss are intended to pass to the buyer on shipment. A stipulation in a C. & F. contract that the seller shall effect insurance on the goods and charge the buyer with the premium (in effect that he shall act as the buyer's agent for that purpose) is entirely in keeping with the pattern. On the other hand, it often happens that the buyer is in a more advantageous position than the seller to effect insurance on the goods or that he has in force an "open" or "floating" policy covering all shipments made by him or to him, in either of which events the C. & F. term is adequate without mention of insurance.

17. It is to be remembered that in a French contract the term "C.A.F." does not mean "Cost and Freight" but has

exactly the same meaning as the term "C.I.F." since it is merely the French equivalent of that term. The "A" does not stand for "and" but for "assurance" which means insurance.

**Cross references:**

Point 4: Section 2—323.

Point 6: Section 2—509(1) (a).

Point 9: Sections 2—508 and 2—605(1) (a).

Point 12: Sections 2—321(3), 2—512 and 2—513(3) and Article 5.

**Definitional cross references:**

"Bill of lading". Section 1—201.

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Goods". Section 2—105.

"Rights". Section 1—201.

"Seller". Section 2—103.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

No North Carolina cases or statutes were found dealing with C.I.F. or C. & F. terms in sales contracts. This provision codifies for the most part case law de-

veloped over the country concerning the C.I.F. contract. See Official Comment. See Vold, Sales 199 et seq. (2d ed.).

This is entirely new material.

**§ 25-2-321. C.I.F. or C. & F.: "Net landed weights"; "payment on arrival"; warranty of condition on arrival.**—Under a contract containing a term C.I.F. or C. & F.

(1) Where the price is based on or is to be adjusted according to "net landed weights," "delivered weights," "out turn" quantity or quality or the like, unless otherwise agreed the seller must reasonably estimate the price. The payment due on tender of the documents called for by the contract is the amount so estimated, but after final adjustment of the price a settlement must be made with commercial promptness.

(2) An agreement described in subsection (1) or any warranty of quality or condition of the goods on arrival places upon the seller the risk of ordinary deterioration, shrinkage and the like in transportation but has no effect on the place or time of identification to the contract for sale or delivery or on the passing of the risk of loss.

(3) Unless otherwise agreed where the contract provides for payment on or after arrival of the goods the seller must before payment allow such preliminary inspection as is feasible; but if the goods are lost delivery of the documents and payment are due when the goods should have arrived. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

This section deals with two variations of the C.I.F. contract which have evolved in mercantile practice but are entirely consistent with the basic C.I.F. pattern. Subsections (1) and (2), which provide for a shift to the seller of the risk of quality and weight deterioration during shipment, are designed to conform the law to the best mercantile practice and usage without changing the legal consequences of the C.I.F. or C. & F. term as to the passing of marine risks to the buyer at the point of shipment. Subsection (3) provides that where under the contract documents are to be presented for payment after arrival of the goods, this amounts merely to a postponement of the

payment under the C.I.F. contract and is not to be confused with the "no arrival, no sale" contract. If the goods are lost, delivery of the documents and payment against them are due when the goods should have arrived. The clause for payment on or after arrival is not to be construed as such a condition precedent to payment that if the goods are lost in transit the buyer need never pay and the seller must bear the loss.

**Cross reference:**

Section 2—324.

**Definitional cross references:**

"Agreement". Section 1—201.

"Contract". Section 1—201.

"Delivery". Section 1—201.

"Goods". Section 2—105.

"Seller". Section 2—103.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

As previously stated, there were no C.I.F. or C. & F. cases or statutes in North Carolina.

This is entirely new material.

§ 25-2-322. **Delivery "ex-ship."**—(1) Unless otherwise agreed a term for delivery of goods "ex-ship" (which means from the carrying vessel) or in equivalent language is not restricted to a particular ship and requires delivery from a ship which has reached a place at the named port of destination where goods of the kind are usually discharged.

(2) Under such a term unless otherwise agreed

(a) the seller must discharge all liens arising out of the carriage and furnish the buyer with a direction which puts the carrier under a duty to deliver the goods; and

(b) the risk of loss does not pass to the buyer until the goods leave the ship's tackle or are otherwise properly unloaded. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. The delivery term, "ex ship", as between seller and buyer, is the reverse of the f.a.s. term covered.

2. Delivery need not be made from any particular vessel under a clause calling for delivery "ex ship", even though a vessel on which shipment is to be made originally is named in the contract, unless the agreement by appropriate language, restricts the clause to delivery from a named vessel.

3. The appropriate place and manner of unloading at the port of destination depend upon the nature of the goods and the facilities and usages of the port.

4. A contract fixing a price "ex ship"

with payment "cash against documents" calls only for such documents as are appropriate to the contract. Tender of a delivery order and of a receipt for the freight after the arrival of the carrying vessel is adequate. The seller is not required to tender a bill of lading as a document of title nor is he required to insure the goods for the buyer's benefit, as the goods are not at the buyer's risk during the voyage.

**Cross reference:**

Point 1: Section 2—319(2).

**Definitional cross references:**

"Buyer". Section 2—103.

"Goods". Section 2—105.

"Seller". Section 2—103.

"Term". Section 1—201.

#### NORTH CAROLINA COMMENT

There were no cases or statutes dealing with "ex-ship" provisions found in North Carolina. This provision is somewhat the overseas shipment parallel to the "F.O.B. destination" contract on an overland shipment wherein the risk remains with the seller until they reach their destination. Compare *Peed v. Burleson's, Inc.*, 244 N.C. 437, 94 S.E.2d 351 (1956). See GS 25-2-319. The difference, however, is that

this provision shifts the risk and expenses to the buyer at the unloading from the vessel, while in the F.O.B. contract the risk normally passes upon tender of the goods at the destination even though they may still be in the possession of the carrier.

This section is entirely new and has no statutory or decisional parallel in prior North Carolina law.

§ 25-2-323. **Form of bill of lading required in overseas shipment; "overseas."**—(1) Where the contract contemplates overseas shipment and contains a term C.I.F. or C. & F. or F.O.B. vessel, the seller unless otherwise agreed must obtain a negotiable bill of lading stating that the goods have been loaded on board or, in the case of a term C.I.F. or C. & F., received for shipment.

(2) Where in a case within subsection (1) a bill of lading has been issued in a set of parts, unless otherwise agreed if the documents are not to be sent from abroad the buyer may demand tender of the full set; otherwise only one part of the bill of lading need be tendered. Even if the agreement expressly requires a full set

(a) due tender of a single part is acceptable within the provisions of this article on cure of improper delivery (subsection (1) of § 25-2-508); and

(b) even though the full set is demanded, if the documents are sent from abroad the person tendering an incomplete set may nevertheless require payment upon furnishing an indemnity which the buyer in good faith deems adequate.

(3) A shipment by water or by air or a contract contemplating such shipment is "overseas" insofar as by usage of trade or agreement it is subject to the commer-



cial, financing or shipping practices characteristic of international deep water commerce. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. Subsection (1) follows the "American" rule that a regular bill of lading indicating delivery of the goods at the dock for shipment is sufficient, except under a term "F.O.B. vessel." See Section 2—319 and comment thereto.

2. Subsection (2) deals with the problem of bills of lading covering deep water shipments, issued not as a single bill of lading but in a set of parts, each part referring to the other parts and the entire set constituting in commercial practice and at law a single bill of lading. Commercial practice in international commerce is to accept and pay against presentation of the first part of a set if the part is sent from overseas even though the contract of the buyer requires presentation of a full set of bills of lading provided adequate indemnity for the missing parts is forthcoming.

This subsection codifies that practice as between buyer and seller. Article 5 (Sec-

tion 5—113) authorizes banks presenting drafts under letters of credit to give indemnities against the missing parts, and this subsection means that the buyer must accept and act on such indemnities if he in good faith deems them adequate. But neither this subsection nor Article 5 decides whether a bank which has issued a letter of credit is similarly bound. The issuing bank's obligation under a letter of credit is independent and depends on its own terms. See Article 5.

#### Cross references:

Sections 2—508(2), 5—113.

#### Definitional cross references:

"Bill of lading". Section 1—201.

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Delivery". Section 1—201.

"Financing agency". Section 2—104.

"Person". Section 1—201.

"Seller". Section 2—103.

"Send". Section 1—201.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

There is neither decisional nor case law bearing upon the subject matter of this section. This section is entirely new in North Carolina law.

§ 25-2-324. "No arrival, no sale" term.—Under a term "no arrival, no sale" or terms of like meaning, unless otherwise agreed,

(a) the seller must properly ship conforming goods and if they arrive by any means he must tender them on arrival but he assumes no obligation that the goods will arrive unless he has caused the non-arrival; and

(b) where without fault of the seller the goods are in part lost or have so deteriorated as no longer to conform to the contract or arrive after the contract time, the buyer may proceed as if there had been casualty to identified goods (§ 25-2-613). (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. The "no arrival, no sale" term in a "destination" overseas contract leaves risk of loss on the seller out gives him an exemption from liability for non-delivery. Both the nature of the case and the duty of good faith require that the seller must not interfere with the arrival of the goods in any way. If the circumstances impose upon him the responsibility for making or arranging the shipment, he must have a shipment made despite the exemption clause. Further, the shipment made must be a conforming one, for the exemption under a "no arrival, no sale" term applies only to the hazards of transportation and

the goods must be proper in all other respects.

The reason of this section is that where the seller is reselling goods bought by him as shipped by another and this fact is known to the buyer, so that the seller is not under any obligation to make the shipment himself, the seller is entitled under the "no arrival, no sale" clause to exemption from payment of damages for non-delivery if the goods do not arrive or if the goods which actually arrive are non-conforming. This does not extend to sellers who arrange shipment by their own agents, in which case the clause is limited to casualty due to marine hazards. But sellers who make known that they are

contracting only with respect to what will be delivered to them by parties over whom they assume no control are entitled to the full quantum of the exemption.

2. The provisions of this Article on identification must be read together with the present section in order to bring the exemption into application. Until there is some designation of the goods in a particular shipment or on a particular ship as being those to which the contract refers there can be no application of an exemption for their non-arrival.

3. The seller's duty to tender the agreed or declared goods if they do arrive is not impaired because of their delay in arrival or by their arrival after transshipment.

4. The phrase "to arrive" is often employed in the same sense as "no arrival, no sale" and may then be given the same effect. But a "to arrive" term, added to a C.I.F. or C. & F. contract, does not have the full meaning given by this section to "no arrival, no sale". Such a "to arrive" term is usually intended to operate only to the extent that the risks are not covered by the agreed insurance and the loss or casualty is due to such uncovered hazards. In some instances the "to arrive" term may be regarded as a time of payment term, or, in the case of the reselling seller discussed in point 1 above, as negat-

ing responsibility for conformity of the goods, if they arrive, to any description which was based on his good faith belief of the quality. Whether this is the intention of the parties is a question of fact based on all the circumstances surrounding the resale and in case of ambiguity the rules of Sections 2—316 and 2—317 apply to preclude dishonor.

5. Paragraph (b) applies where goods arrive impaired by damage or partial loss during transportation and makes the policy of this Article on casualty to identified goods applicable to such a situation. For the term cannot be regarded as intending to give the seller an unforeseen profit through casualty; it is intended only to protect him from loss due to causes beyond his control.

#### Cross references:

Point 1: Section 1—203.

Point 2: Section 2—501(a) and (c).

Point 5: Section 2—613.

#### Definitional cross references:

"Buyer". Section 2—103.

"Conforming". Section 2—106.

"Contract". Section 1—201.

"Fault". Section 1—201.

"Goods". Section 2—105.

"Sale". Section 2—106.

"Seller". Section 2—103.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

There is no North Carolina authority on the subject matter of this section. It allocates risks in regard to shipments where seller bears risk of loss during shipment, but negates any liability to buyer where

shipment does not arrive and seller is not responsible for its failure to arrive.

This is entirely new to North Carolina law.

**§ 25-2-325. "Letter of credit" term; "confirmed credit."**—(1) Failure of the buyer seasonably to furnish an agreed letter of credit is a breach of the contract for sale.

(2) The delivery to seller of a proper letter of credit suspends the buyer's obligation to pay. If the letter of credit is dishonored, the seller may on seasonable notification to the buyer require payment directly from him.

(3) Unless otherwise agreed the term "letter of credit" or "banker's credit" in a contract for sale means an irrevocable credit issued by a financing agency of good repute and, where the shipment is overseas, of good international repute. The term "confirmed credit" means that the credit must also carry the direct obligation of such an agency which does business in the seller's financial market. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** To express the established commercial and banking understanding as to the meaning and effects of terms calling for "letters of credit" or "confirmed credit":

1. Subsection (2) follows the general policy of this Article and Article 3 (Sec-

tion 3—802) on conditional payment, under which payment by check or other short-term instrument is not ordinarily final as between the parties if the recipient duly presents the instrument and honor is refused. Thus the furnishing of a letter of credit does not substitute the financing agency's obligation for the buyer's, but

the seller must first give the buyer reasonable notice of his intention to demand direct payment from him.

2. Subsection (3) requires that the credit be irrevocable and be a prime credit as determined by the standing of the issuer. It is not necessary, unless otherwise agreed, that the credit be a negotiation credit; the seller can finance himself by an assignment of the proceeds under Section 5—116(2).

3. The definition of "confirmed credit" is drawn on the supposition that the credit is issued by a bank which is not doing direct business in the seller's financial market; there is no intention to require

the obligation of two banks both local to the seller.

**Cross references:**

Sections 2—403, 2—511(3) and 3—802 and Article 5.

**Definitional cross references:**

"Buyer". Section 2—103.

"Contract for sale". Section 2—106.

"Draft". Section 3—104.

"Financing agency". Section 2—104.

"Notifies". Section 1—201.

"Overseas". Section 2—323.

"Purchaser". Section 1—201.

"Seasonably". Section 1—204.

"Seller". Section 2—103.

"Term". Section 1—201.

**NORTH CAROLINA COMMENT**

North Carolina has no prior statutory or decisional law on the matters covered by this section. This section, as other sections starting with GS 25-2-319, continues

to define and fix the meanings of numerous commercial terms and abbreviations.

This section is new to North Carolina law.

**§ 25-2-326. Sale on approval and sale or return; consignment sales and rights of creditors.**—(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is

(a) a "sale on approval" if the goods are delivered primarily for use, and

(b) a "sale or return" if the goods are delivered primarily for resale.

(2) Except as provided in subsection (3), goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as "on consignment" or "on memorandum." However, this subsection is not applicable if the person making delivery

(a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or

(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or

(c) complies with the filing provisions of the article on secured transactions (article 9).

(4) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this article (§ 25-2-201) and as contradicting the sale aspect of the contract within the provisions of this article on parol or extrinsic evidence (§ 25-2-202). (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 19(3), Uniform Sales Act.

**Changes:** Completely rewritten in this and the succeeding section.

**Purposes of changes:** To make it clear that:

1. A "sale on approval" or "sale or return" is distinct from other types of trans-

actions with which they have frequently been confused. The type of "sale on approval," "on trial" or "on satisfaction" dealt with involves a contract under which the seller undertakes a particular business risk to satisfy his prospective buyer with the appearance or performance of the goods in question. The goods are



delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them. The price has already been agreed. The buyer's willingness to receive and test the goods is the consideration for the seller's engagement to deliver and sell. The type of "sale or return" involved herein is a sale to a merchant whose unwillingness to buy is overcome only by the seller's engagement to take back the goods (or any commercial unit of goods) in lieu of payment if they fail to be resold. These two transactions are so strongly delineated in practice and in general understanding that every presumption runs against a delivery to a consumer being a "sale or return" and against a delivery to a merchant for resale being a "sale on approval."

The right to return the goods for failure to conform to the contract does not make the transaction a "sale on approval" or "sale or return" and has nothing to do with this and the following section. The present section is not concerned with remedies for breach of contract. It deals instead with a power given by the contract to turn back the goods even though they are wholly as warranted.

This section nevertheless pre-supposes that a contract for sale is contemplated by the parties although that contract may be of the peculiar character here described.

Where the buyer's obligation as a buyer is conditioned not on his personal approval but on the article's passing a described objective test, the risk of loss by casualty pending the test is properly the seller's and proper return is at his expense. On the point of "satisfaction" as meaning "reasonable satisfaction" where an industrial machine is involved, this Article takes no position.

2. Pursuant to the general policies of this Act which require good faith not only between the parties to the sales contract, but as against interested third parties, subsection (3) resolves all reasonable doubts

as to the nature of the transaction in favor of the general creditors of the buyer. As against such creditors words such as "on consignment" or "on memorandum", with or without words of reservation of title in the seller, are disregarded when the buyer has a place of business at which he deals in goods of the kind involved. A necessary exception is made where the buyer is known to be engaged primarily in selling the goods of others or is selling under a relevant sign law, or the seller complies with the filing provisions of Article 9 as if his interest were a security interest. However, there is no intent in this section to narrow the protection afforded to third parties in any jurisdiction which has a selling Factors Act. The purpose of the exception is merely to limit the effect of the present subsection itself, in the absence of any such Factors Act, to cases in which creditors of the buyer may reasonably be deemed to have been misled by the secret reservation.

3. Subsection (4) resolves a conflict in the pre-existing case law by recognition that an "or return" provision is so definitely at odds with any ordinary contract for sale of goods that where written agreements are involved it must be contained in a written memorandum. The "or return" aspect of a sales contract must be treated as a separate contract under the Statute of Frauds section and as contradicting the sale insofar as questions of parole or extrinsic evidence are concerned.

#### Cross references:

Point 2: Article 9.

Point 3: Sections 2-201 and 2-202.

#### Definitional Cross References:

"Between merchants". Section 2-104.

"Buyer". Section 2-103.

"Conform". Section 2-106.

"Contract for sale" Section 2-106.

"Creditor". Section 1-201.

"Goods". Section 2-105.

"Sale". Section 2-106.

"Seller". Section 2-103.

### NORTH CAROLINA COMMENT

*Subsections (1) (a) and (2) define and state the effect of a "sale on approval."* There is no real change in prior North Carolina law. See *United State v. One 1955 Model Ford*, 157 F. Supp. 798 (E.D.N.C. 1957); *Glascok v. Hazell*, 109 N.C. 145, 13 S.E. 789 (1891), that in a sale on approval where goods are subject to approval by the vendee, title does not vest in the vendee until such approval is manifested. This, of course, would determine the rights of creditors, risk of loss, etc., in North Carolina.

There are apparently no "sale or return" cases in North Carolina which treat the exact subject matter of these subsections, but subsections (1) (b) and (2) relating to "sale or return" contracts are in accord with the general understanding of the consequences of this type contract. (Title passes immediately upon delivery to the buyer subject to the buyer's right, a condition subsequent, to return the item to the seller and to revest the title in the seller. The ordinary incidents of ownership are in the buyer until the buyer's option

to return is exercised. This would include the risk of loss, rights of creditors, etc.) See Vold, Sales 382-3 (2d ed.). Compare *Fountain v. Jones*, 181 N.C. 27, 106 S.E. 26 (1921). These subsections more clearly define the terms "sale on approval" and "sale or return" and their consequences in North Carolina but there is no real change in prior law.

Subsection (3) provides that where a person has a place of business at which he deals in goods of the kind received for sale under a name other than that of the person making delivery, words such as "on consignment" purporting to reserve title until payment will not prevent a transaction from being a sale or return, thus subjecting the goods to levy by the creditors of the person receiving delivery. Thus, possible doubts as to the nature of the transaction are resolved in favor of creditors of the person receiving delivery. The possibility of using a form of bailment to conceal what is essentially a sale is reduced. Provisions are made whereby the seller-consignor can protect himself by following specified procedures.

Subsection (3) is entirely new in North Carolina law.

Subsection (4) states, in effect, that any "or return" provision is so definitely at odds with any ordinary contract for the sale of goods that where written agreements are involved the "or return" provision must be contained in a written memorandum. It contradicts the "sale" aspect of the contract within the parol evidence rule. While North Carolina did not have the statute of frauds as to contracts for the sale of personal property, it did have the parol evidence rule. Subsection (4) accords with the case of *Shoop Family Medicine Co. v. Davenport*, 163 N.C. 294, 79 S.E. 602 (1913) and *Shoop Medicine Co. v. J. A. Mizell & Co.*, 148 N.C. 384, 62 S.E. 511 (1908). Where there is a written contract of sale the buyer may not introduce parol agreement allowing return of the article purchased not contained in the written agreement. The UCC provision accords in result with prior North Carolina law.

### § 25-2-327. Special incidents of sale on approval and sale or return.

—(1) Under a sale on approval unless otherwise agreed

(a) although the goods are identified to the contract the risk of loss and the title do not pass to the buyer until acceptance; and

(b) use of the goods consistent with the purpose of trial is not acceptance but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract acceptance of any part is acceptance of the whole; and

(c) after due notification of election to return, the return is at the seller's risk and expense but a merchant buyer must follow any reasonable instructions.

(2) Under a sale or return unless otherwise agreed

(a) the option to return extends to the whole or any commercial unit of the goods while in substantially their original condition, but must be exercised seasonably; and

(b) the return is at the buyer's risk and expense. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 19(3), Uniform Sales Act.

**Changes:** Completely rewritten in preceding and this section.

**Purposes of changes:** To make it clear that:

1. In the case of a sale on approval:

If all of the goods involved conform to the contract, the buyer's acceptance of part of the goods constitutes acceptance of the whole. Acceptance of part falls outside the normal intent of the parties in the "on approval" situation and the policy of this Article allowing partial acceptance of a defective delivery has no application here. A case where a buyer takes home

two dresses to select one commonly involves two distinct contracts; if not, it is covered by the words "unless otherwise agreed".

2. In the case of a sale or return, the return of any unsold unit merely because it is unsold is the normal intent of the "sale or return" provision, and therefore the right to return for this reason alone is independent of any other action under the contract which would turn on wholly different considerations. On the other hand, where the return of goods is for breach, including return of items resold by the buyer and returned by the ultimate purchasers because of defects, the return

procedure is governed not by the present section but by the provisions on the effects and revocation of acceptance.

3. In the case of a sale on approval the risk rests on the seller until acceptance of the goods by the buyer, while in a sale or return the risk remains throughout on the buyer.

4. Notice of election to return given by the buyer in a sale on approval is sufficient to relieve him of any further liability. Actual return by the buyer to the seller is required in the case of a sale or return contract. What constitutes due "giving" of notice, as required in "on approval" sales, is governed by the provisions on good faith and notice. "Seasonable" is used here as defined in Section 1—204. Nevertheless, the provisions of both this Article and of the contract on this point must be read with commercial reason and with full attention to good faith.

#### NORTH CAROLINA COMMENT

*Subsection (1) (a)* accords with United States v. One 1955 Model Ford, 157 F. Supp. 798 (E.D.N.C. 1957) and Glascock v. Hazell, 109 N.C. 145, 13 S.E. 789 (1891).

*Subsection (1) (b)* would seem to accord with North Carolina cases that a right of inspection must be exercised within a reasonable time or the buyer will become owner and the right to reject is waived. *Fountain v. Jones*, 181 N.C. 27, 106 S.E. 26 (1921). A use of the item purchased, however, which is consistent with purpose of trial is not acceptance. See *Parker v. Fenwick*, 138 N.C. 209, 50 S.E. 627 (1905).

*Subsection (1) (c)* has no statutory or decisional parallel in prior North Carolina law but seems reasonable as to what the law would probably have been in North Carolina as pieced together from previ-

#### Cross references:

Point 1: Sections 2—501, 2—601 and 2—603.

Point 2: Sections 2—607 and 2—608.

Point 4: Sections 1—201 and 1—204.

#### Definitional cross references:

"Agreed". Section 1—201.

"Buyer". Section 2—103.

"Commercial unit". Section 2—105.

"Conform". Section 2—106.

"Contract". Section 1—201.

"Goods". Section 2—105.

"Merchant". Section 2—104.

"Notifies". Section 1—201.

"Notification". Section 1—201.

"Sale on approval". Section 2—326.

"Sale or return". Section 2—326.

"Seasonably". Section 1—204.

"Seller". Section 2—103.

ously cited cases wherein title determines such crucial matters as the risk of loss and creditors' rights.

*Subsection (2) (a)* is in substantial accord with prior North Carolina law. See *Fountain v. Jones*, 181 N.C. 27, 106 S.E. 26 (1921). The addition of the provision for return of "any commercial unit of goods" is new to North Carolina law.

*Subsection (2) (b)*: There is no statutory or decisional parallel to subsection (2) (b) in prior North Carolina law, but since under such law title passed to a buyer on a "sale or return" contract, subject to being revested in the seller upon redelivery, it would appear that until such redelivery the expenses of redelivery and the risk of loss should be on the buyer. See again *Fountain v. Jones*, 181 N.C. 27, 106 S.E. 26 (1921).

**§ 25-2-328. Sale by auction.**—(1) In a sale by auction if goods are put up in lots each lot is the subject of a separate sale.

(2) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. Where a bid is made while the hammer is falling in acceptance of a prior bid the auctioneer may in his discretion reopen the bidding or declare the goods sold under the bid on which the hammer was falling.

(3) Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may withdraw the goods at any time until he announces completion of the sale. In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time. In either case a bidder may retract his bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.

(4) If the auctioneer knowingly receives a bid on the seller's behalf or the seller makes or procures such a bid, and notice has not been given that liberty for such



bidding is reserved, the buyer may at his option avoid the sale or take the goods at the price of the last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at a forced sale. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 21, Uniform Sales Act.

**Changes:** Completely rewritten.

**Purposes of changes:** To make it clear that:

1. The auctioneer may in his discretion either reopen the bidding or close the sale on the bid on which the hammer was falling when a bid is made at that moment. The recognition of a bid of this kind by the auctioneer in his discretion does not mean a closing in favor of such a bidder, but only that the bid has been accepted as a continuation of the bidding. If recognized, such a bid discharges the bid on which the hammer was falling when it was made.

2. An auction "with reserve" is the normal procedure. The crucial point, however, for determining the nature of an auction is the "putting up" of the goods. This Article accepts the view that the goods may be withdrawn before they are actually "put up," regardless of whether the auction is advertised as one without reserve, without liability on the part of the auction announcer to persons who are present.

This is subject to any peculiar facts which might bring the case within the "firm offer" principle of this Article, but an offer to persons generally would require unmistakable language in order to fall within that section. The prior announcement of the nature of the auction either as with reserve or without reserve will, however, enter as an "explicit term" in the "putting up" of the goods and conduct thereafter must be governed accordingly. The present section continues the prior rule permitting withdrawal of bids in auctions both with and without reserve; and the rule is made explicit that the retraction of a bid does not revive a prior bid.

#### Cross reference:

Point 2: Section 2—205.

#### Definitional cross references:

"Buyer". Section 2—103.

"Good faith" Section 1—201.

"Goods". Section 2—105.

"Lot". Section 2—105.

"Notice". Section 1—201.

"Sale" Section 2—106.

"Seller". Section 2—103.

#### NORTH CAROLINA COMMENT

*Subsection (1)* accords with the general understanding of the law of sales by auction. It is practically a verbatim copy of § 21 (1) of the Uniform Sales Act, which is generally thought of as a codification of the common law of sales in most particulars.

*Subsection (2):* The first sentence of subsection (2) follows the Uniform Sales Act, § 21 (2), which is the general law as to when title passes in auction sales. Compare *Love v. Harris*, 156 N.C. 88, 72 S.E. 828 (1911). There are apparently no cases in North Carolina relating to reopening bids when a bid is made while the hammer is falling. This is covered by the second sentence of subsection (2).

*Subsection (3):* While no cases have been found in connection with the reserve rights of a seller at an auction which are covered by subsection (3), this provision accords with the Restatement, Contracts, § 27 (1932), that a sale by auction is with reserve unless otherwise indicated, entitling the seller to withdraw the goods at any

time before the bid is accepted. It also accords with the Uniform Sales Act, § 21 (2). It is believed that this also accords with prior North Carolina law.

*Subsection (4)* follows prior North Carolina law in permitting a buyer to avoid an auction sale at which the seller or his agent bid. See *Morehead v. Hunt*, 16 N.C. 35 (1826); *Woods v. Hall*, 16 N.C. 411 (1830); *McDowell v. Simms*, 41 N.C. 278 (1849). That by-bidding may be permissible if notice is given to the vendee, see *McDowell v. Simms*, 41 N.C. 278 (1849). This section of the UCC adds, however, a provision not in the prior North Carolina law that the buyer has the option of taking at the last bona fide bid made where by-bidding by the seller or his agent is present. Another innovation is that at forced sales unannounced bidding on behalf of the seller is permitted.

For the most part this section of the UCC restates and amplifies generally accepted rules relating to auction sales. There are few innovations.

## PART 4.

## TITLE, CREDITORS AND GOOD FAITH PURCHASERS.

**§ 25-2-401. Passing of title; reservation for security; limited application of this section.**—Each provision of this article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this article and matters concerning title become material the following rules apply:

(1) Title to goods cannot pass under a contract for sale prior to their identification to the contract (§ 25-2-501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this chapter. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the article on secured transactions (article 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading

(a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(b) if the contract requires delivery at destination, title passes on tender there.

(3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods,

(a) if the seller is to deliver a document of title, title passes at the time when and the place where he delivers such documents; or

(b) if the goods are at the time of contracting already identified and no documents are to be delivered, title passes at the time and place of contracting.

(4) A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance reverts title to the goods in the seller. Such reversion occurs by operation of law and is not a "sale." (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** See generally, Sections 17, 18, 19 and 20, Uniform Sales Act.

**Purposes:** To make it clear that:

1. This Article deals with the issues between seller and buyer in terms of step by step performance or non-performance under the contract for sale and not in terms of whether or not "title" to the goods has passed. That the rules of this section in no way alter the rights of either the buyer, seller or third parties declared elsewhere in the Article is made clear by the preamble of this section. This section, however, in no way intends to indicate which line of interpretation should be followed in cases where the applicability of "public" regulation depends upon a "sale" or upon location of "title" without further definition. The basic policy of this Article that known purpose and reason

should govern interpretation cannot extend beyond the scope of its own provisions. It is therefore necessary to state what a "sale" is and when title passes under this Article in case the courts deem any public regulation to incorporate the defined term of the "private" law.

2. "Future" goods cannot be the subject of a present sale. Before title can pass the goods must be identified in the manner set forth in Section 2—501. The parties, however, have full liberty to arrange by specific terms for the passing of title to goods which are existing.

3. The "special property" of the buyer in goods identified to the contract is excluded from the definition of "security interest"; its incidents are defined in provisions of this Article such as those on the rights of the seller's creditors, on good faith purchase, on the buyer's right to

goods on the seller's insolvency, and on the buyer's right to specific performance or replevin.

4. The factual situations in subsections (2) and (3) upon which passage of title turn actually base the test upon the time when the seller has finally committed himself in regard to specific goods. Thus in a "shipment" contract he commits himself by the act of making the shipment. If shipment is not contemplated subsection (3) turns on the seller's final commitment, i. e. the delivery of documents or the making of the contract.

**Cross references:**

Point 2: Sections 2—102, 2—501 and 2—502.

Point 3: Sections 1—201, 2—402, 2—403, 2—502 and 2—716.

**Definitional cross references:**

"Agreement". Section 1—201.

"Bill of lading". Section 1—201.

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Delivery". Section 1—201.

"Document of title". Section 1—201.

"Good faith". Section 2—103.

"Goods". Section 2—105.

"Party". Section 1—201.

"Purchaser". Section 1—201.

"Receipt" of goods. Section 2—103.

"Remedy". Section 1—201.

"Rights". Section 1—201.

"Sale". Section 2—106.

"Security interest". Section 1—201.

"Seller". Section 2—103.

"Send". Section 1—201.

**NORTH CAROLINA COMMENT**

The UCC abandons "lump concept thinking," that made rights, obligations and remedies of sellers, buyers and third parties dependent on the location of the title of goods at a particular time. It substitutes therefor "narrow issue thinking" by providing specific provisions with respect to the various rights and duties of the buyer and seller which are not predicated on location of title.

For the most part, the same results will be obtained in North Carolina under the UCC as under prior law although the "search for title" theory of deciding many sales cases is abandoned.

*Subsection (1):* The first sentence of subsection (1) accords with *Blakely v. Patrick*, 67 N.C. 45 (1872); *Waldo v. Belcher*, 33 N.C. 609 (1850), that title cannot pass until goods are identified or appropriated to the contract.

The second sentence of subsection (1) is contrary to prior North Carolina law. See *Early & Daniels Co. v. Aulander Flour Mills*, 187 N.C. 344, 121 S.E. 539 (1924), that where, by form of bill of lading, seller retains title to goods shipped for security purposes, other incidents such as risk of loss follows the title. See also *Penniman v. Winder*, 180 N.C. 73, 103 S.E. 908 (1920). The buyer and seller, of course, can

provide by their contract when title to goods shall pass.

*Subsection (2)* accords with *Richardson v. Insurance Co. of North America*, 136 N.C.314, 48 S.E. 733 (1904); *Teague v. Howard Grocery Co.*, 175 N.C. 195, 95 S.E. 173 (1918); *Jenkins v. Jarrett*, 70 N.C. 255 (1874), except that if goods are shipped and seller retains shipping documents such as the bill of lading made out to "order of seller," the seller retains title and the risk of loss is on the seller. See *Early & Daniels Co. v. Aulander Flour Mills*, 187 N.C. 344, 121 S.E. 539 (1924). See also *Peed v. Burleson's, Inc.*, 244 N.C. 437, 94 S.E.2d 351 (1956), that title and risk of loss remain in the seller if by the contract the seller agrees to deliver to the buyer at the destination. This accords with subsection (2) (b).

*Subsection (3)* accords with prior North Carolina law. See above paragraph. Title passes upon making contract if goods are in a deliverable state.

*Subsection (4)* accords with prior North Carolina law that title revests in the seller upon a rescission by the buyer. See *Hutchins v. Davis*, 230 N.C. 67, 52 S.E.2d 210 (1949). The part of the subsection which places the title in the seller even if the buyer makes a *wrongful* repudiation of the contract is new.

**§ 25-2-402. Rights of seller's creditors against sold goods.—**

(1) Except as provided in subsections (2) and (3), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this article (§§ 25-2-502 and 25-2-716).

(2) A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except



that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

(3) Nothing in this article shall be deemed to impair the rights of creditors of the seller

(a) under the provisions of the article on secured transactions (article 9); or

(b) where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security or the like and is made under circumstances which under any rule of law of the state where the goods are situated would apart from this article constitute the transaction a fraudulent transfer or voidable preference. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Subsection (2)—Section 26, Uniform Sales Act; Subsections (1) and (3)—none.

**Changes:** Rephrased.

**Purposes of changes and new matter:** To avoid confusion on ordinary issues between current sellers and buyers and issues in the field of preference and hindrance by making it clear that:

1. Local law on questions of hindrance of creditors by the seller's retention of possession of the goods are outside the scope of this Article, but retention of possession in the current course of trade is legitimate. Transactions which fall within the law's policy against improper preferences are reserved from the protection of this Article.

2. The retention of possession of the goods by a merchant seller for a com-

mercially reasonable time after a sale or identification in current course is exempted from attack as fraudulent. Similarly, the provisions of subsection (3) have no application to identification or delivery made in the current course of trade, as measured against general commercial understanding of what a "current" transaction is.

**Definitional cross references:**

"Contract for sale". Section 2—106.

"Creditor". Section 1—201.

"Good faith". Section 2—103.

"Goods". Section 2—105.

"Merchant". Section 2—104.

"Money". Section 1—201.

"Reasonable time". Section 1—204.

"Rights". Section 1—201.

"Sale". Section 2—106.

"Seller". Section 2—103.

#### NORTH CAROLINA COMMENT

This section, the intent of which is to preserve local law except where local law would make retention of possession of goods by a merchant-seller fraudulent as

against creditors if such retention is in the ordinary course of business, does not affect North Carolina law.

**§ 25-2-403. Power to transfer; good faith purchase of goods; "entrusting."**—(1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though

(a) the transferor was deceived as to the identity of the purchaser, or

(b) the delivery was in exchange for a check which is later dishonored, or

(c) it was agreed that the transaction was to be a "cash sale," or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(3) "Entrusting" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.

(4) The rights of other purchasers of goods and of lien creditors are governed by the articles on secured transactions (article 9), bulk transfers (article 6) and documents of title (article 7). (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 20(4), 23, 24, 25, Uniform Sales Act; Section 9, especially 9(2), Uniform Trust Receipts Act; Section 9 Uniform Conditional Sales Act.

**Changes:** Consolidated and rewritten.

**Purposes of changes:** To gather together a series of prior uniform statutory provisions and the case law thereunder and to state a unified and simplified policy on good faith purchase of goods.

1. The basic policy of our law allowing transfer of such title as the transferor has is generally continued and expanded under subsection (1). In this respect the provisions of the section are applicable to a person taking by any form of "purchase" as defined by this Act. Moreover the policy of this Act expressly providing for the application of supplementary general principles of law to sales transactions wherever appropriate joins with the present section to continue unimpaired all rights acquired under the law of agency or of apparent agency or ownership or other estoppel, whether based on statutory provisions or on case law principles. The section also leaves unimpaired the powers given to selling factors under the earlier Factors Acts. In addition subsection (1) provides specifically for the protection of the good faith purchaser for value in a number of specific situations which have been troublesome under prior law.

On the other hand, the contract of purchase is of course limited by its own terms as in a case of pledge for a limited amount or of sale of a fractional interest in goods.

2. The many particular situations in which a buyer in ordinary course of business from a dealer has been protected against reservation of property or other hidden interest are gathered by subsections (2)-(4) into a single principle protecting persons who buys in ordinary course out of inventory. Consignors have no reason to complain, nor have lenders who hold a security interest in the inventory, since the very purpose of goods in inventory is to be turned into cash by sale.

The principle is extended in subsection (3) to fit with the abolition of the old law of "cash sale" by subsection (1) (c). It is also freed from any technicalities depending on the extended law of larceny; such extension of the concept of theft to include trick, particular types of fraud,

and the like is for the purpose of helping conviction of the offender; it has no proper application to the long-standing policy of civil protection of buyers from persons guilty of such trick or fraud. Finally, the policy is extended, in the interest of simplicity and sense, to any entrusting by a bailor; this is in consonance with the explicit provisions of Section 7-205 on the powers of a warehouseman who is also in the business of buying and selling fungible goods of the kind he warehouses. As to entrusting by a secured party, subsection (2) is limited by the more specific provisions of Section 9-307(1), which deny protection to a person buying farm products from a person engaged in farming operations.

3. The definition of "buyer in ordinary course of business" (Section 1-201) is effective here and preserves the essence of the healthy limitations engrafted by the case law on the older statutes. The older loose concept of good faith and wide definition of value combined to create apparent good faith purchasers in many situations in which the result outraged common sense; the court's solution was to protect the original title especially by use of "cash sale" or of over-technical construction of the enabling clauses of the statutes. But such rulings then turned into limitations on the proper protection of buyers in the ordinary market. Section 1-201(9) cuts down the category of buyer in ordinary course in such fashion as to take care of the results of the cases, but with no price either in confusion or in injustice to proper dealings in the normal market.

4. Except as provided in subsection (1), the rights of purchasers other than buyers in ordinary course are left to the Articles on Secured Transactions, Documents of Title, and Bulk Sales.

#### Cross references:

Point 1: Sections 1-103 and 1-201.

Point 2: Sections 1-201, 2-402, 7-205 and 9-307(1)

Points 3 and 4: Sections 1-102, 1-201, 2-104, 2-707 and Articles 6, 7 and 9.

#### Definitional cross references:

"Buyer in ordinary course of business". Section 1-201.

"Good faith" Sections 1-201 and 2-103.

"Goods". Section 2-105.

"Person". Section 1-201.

"Purchaser". Section 1—201.

"Signed". Section 1—201.

"Term". Section 1—201.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* The first sentence of subsection (1), which relates to persons who are not "merchants," accords with prior North Carolina law that the fact that the owner has entrusted the mere possession and control of personal property to another is ordinarily insufficient to estop him from asserting his title against a person who has dealt with the possessor on the faith of his apparent ownership or authority to sell. But if the seller, in addition to mere possession, is given indicia of title by the true owner or the true owner by his conduct clothes the possessor with apparent title or apparent power of disposition, third parties who are induced to deal with the possessor shall be protected. See *Handley Motor Co. v. Wood*, 237 N.C. 318, 75 S.E.2d 312 (1953); *Wilson v. Commercial Fin. Co.*, 239 N.C. 349, 79 S.E.2d 908 (1953).

The second provision of this subsection changes North Carolina law. While subsection (1) (a) has no case or statutory parallel in North Carolina, subsection (1) (b) is contrary to prior North Carolina law. In North Carolina if a buyer gave a bad check which was dishonored, the buyer took no title and could not convey a good title to a bona fide purchaser. See *Wilson v. Commercial Fin. Co.*, 239 N.C. 349, 79 S.E.2d 908 (1953). If the seller who took a bad check, however, gave to the buyer an indicium of title upon which a bona fide purchaser subsequently relies, the seller would be estopped to assert his title as against the bona fide purchaser. *Wilson v. Commercial Fin. Co.*, 239 N.C. 349, 79 S.E.2d 908 (1953); *Handley Motor Co. v. Wood*, 237 N.C. 318, 75 S.E.2d 312 (1953).

This UCC provision, subsection (1) (b), permits a buyer, who has procured delivery of goods by a check that is later dishonored, to transfer good title to a good faith purchaser for value. The result of the UCC provision is to make the title procured on a bad or worthless check a "voidable" title; before the seller avoids the transaction, the holder of such "avoidable" title can convert it into a "good" title by selling it to a bona fide purchaser for value from whom it cannot be recovered. North Carolina law is materially changed.

Subsection (1) (c) also changes North Carolina law. In North Carolina if a sales contract contemplated a "cash sale,"

that payment of cash and delivery of goods were to be simultaneous as a condition precedent to the passage of title, mere delivery passed no title but passed only possession if the buyer did not pay. The case of *Green River Land Co. v. Bostic*, 168 N.C. 99, 83 S.E. 747 (1914) held that a buyer in a "cash sale" gets no title and getting none has only possession of the goods and can pass no title to another purchaser. Compare *Millhiser v. Endman*, 98 N.C. 292, 3 S.E. 521 (1887).

Subsection (1) (d) is likewise probably contrary to prior North Carolina law. Compare *Ellison v. Hunsinger*, 237 N.C. 619, 75 S.E.2d 884 (1953), which indicates approval of the law of South Carolina that a defrauded owner can recover goods from a bona fide purchaser from one who has obtained them from the true owner by false pretense punishable as a crime. While the case cited applied South Carolina law, the North Carolina court indicated approval. The UCC protects a bona fide purchaser who has bought from one who obtained delivery through fraud even though such fraud is punishable as larcenous under the criminal law. Compare former GS 27-51 of the Uniform Warehouse Receipts Act which is like the UCC in principle on this point.

*Subsection (2)* which relates to persons who are "merchants" changes North Carolina law. Prior North Carolina law provided that the fact that an owner has entrusted someone with mere possession and control of personal property would not, without more, estop the owner from asserting his title against one who had bought from such possessor (in the absence of some estoppel factor). The UCC, however, protects any purchaser who has bought in the ordinary course of business any item entrusted to a "merchant" who deals in goods of the kind entrusted, whether the merchant had any apparent authority to sell or whether or not there was any indicium of title.

*Caveat:* Subsection (2) changes North Carolina law. Will it be safe to leave an item, say a watch or used car, to be repaired if the jeweler or car repairer deals in the sale of used watches or cars in the ordinary course of business?

The UCC specifies different rules for merchants.

*Subsection (3)* defines entrusting and



allows no conditions to defeat the other rules.

*Subsection (4)* states that creditors'

rights are found in other sections, e.g., GS 25-2-403, relating only to purchasers.

## PART 5.

### PERFORMANCE.

**§ 25-2-501. Insurable interest in goods; manner of identification of goods.**—(1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are nonconforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs

(a) when the contract is made if it is for the sale of goods already existing and identified;

(b) if the contract is for the sale of future goods other than those described in paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers;

(c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve months or the next normal harvest season after contracting whichever is longer.

(2) The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in him and where the identification is by the seller alone he may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.

(3) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law. (1965, c. 700, s. 1.)

**Editor's Note.**—The words "after contracting or for the sale of crops to be harvested within twelve months" do not ap-

pear in paragraph (c) of subsection (1) in the 1965 Session Laws.

### OFFICIAL COMMENT

**Prior uniform statutory provision:** See Sections 17 and 19, Uniform Sales Act.

#### Purposes:

1. The present section deals with the manner of identifying goods to the contract so that an insurable interest in the buyer and the rights set forth in the next section will accrue. Generally speaking, identification may be made in any manner "explicitly agreed to" by the parties. The rules of paragraphs (a), (b) and (c) apply only in the absence of such "explicit agreement".

2. In the ordinary case identification of particular existing goods as goods to which the contract refers is unambiguous and may occur in one of many ways. It is possible, however, for the identification to be tentative or contingent. In view of the limited effect given to identification by this Article the general policy is to resolve all doubts in favor of identification.

3. The provision of this section as to "explicit agreement" clarifies the present confusion in the law of sales which has

arisen from the fact that under prior uniform legislation all rules of presumption with reference to the passing of title or to appropriation (which in turn depended upon identification) were regarded as subject to the contrary intention of the parties or of the party appropriating. Such uncertainty is reduced to a minimum under this section by requiring "explicit agreement" of the parties before the rules of paragraphs (a), (b) and (c) are displaced—as they would be by a term giving the buyer power to select the goods. An "explicit" agreement, however, need not necessarily be found in the terms used in the particular transaction. Thus, where a usage of the trade has previously been made explicit by reduction to a standard set of "rules and regulations" currently incorporated by reference into the contracts of the parties, a relevant provision of those "rules and regulations" is "explicit" within the meaning of this section.

4. In view of the limited function of identification there is no requirement in

this section that the goods be in deliverable state or that all of the seller's duties with respect to the processing of the goods be completed in order that identification occur. For example, despite identification the risk of loss remains on the seller under the risk of loss provisions until completion of his duties as to the goods and all of his remedies remain dependent upon his not defaulting under the contract.

5. Undivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under subsection (a) to effect an identification if there is no explicit agreement otherwise. The seller's duty, however, to segregate and deliver according to the contract is not affected by such an identification but is controlled by other provisions of this Article.

6. Identification of crops under paragraph (c) is made upon planting only if they are to be harvested within the year or within the next normal harvest season. The phrase "next normal harvest season" fairly includes nursery stock raised for normally quick "harvest," but plainly ex-

cludes a "timber" crop to which the concept of a harvest "season" is inapplicable.

Paragraph (c) is also applicable to a crop of wool or the young of animals to be born within twelve months after contracting. The product of a lumbering, mining or fishing operation, though seasonal, is not within the concept of "growing". Identification under a contract for all or part of the output of such an operation can be effected early in the operation.

**Cross references:**

Point 1: Section 2—502.

Point 4: Sections 2—509, 2—510 and 2—703.

Point 5: Sections 2—105, 2—308, 2—503 and 2—509.

Point 6: Sections 2—105(1), 2—107(1) and 2—402.

**Definitional cross references:**

"Agreement". Section 1—201.

"Contract for sale". Section 2—106.

"Contract for sale". Section 2—106.

"Future goods". Section 2—105.

"Goods". Section 2—105.

"Notification". Section 1—201.

"Party". Section 1—201.

"Sale". Section 2—106.

"Security interest". Section 1—201.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

*Subsection (1):* It is believed that subsection (1) accords with prior North Carolina law although there are neither cases nor decisions exactly in point.

North Carolina law stated that a person had an insurable interest in subject matter if he had such a relation to, connection with or concern in such subject matter that he would derive pecuniary benefits or advantage from its preservation or would suffer pecuniary loss from its destruction or injury. See *King v. National Union Fire Ins. Co.*, 258 N.C. 432, 128 S.E.2d 849 (1962).

North Carolina law also stated that where a bargain was made for the purchase of goods and nothing was said about payment or delivery, the property passed immediately, so as to cast on the purchaser all future risk, if nothing remained to be done to the goods, although he could not take them away without paying the price. *Richardson v. Insurance Co. of North America*, 136 N.C. 314, 48 S.E. 733 (1904). If the goods were on hand at the time the contract was made, title passed upon the making of the contract. *Teague v. Howard Grocery Co.*, 175 N.C. 195, 95 S.E. 173 (1918). Neither delivery nor payment of

the price was necessary to pass title. *Winborne v. McMahon*, 206 N.C. 31, 173 S.E. 1 (1934); *Jenkins v. Jarrett*, 70 N.C. 255 (1874).

It followed that a buyer under a contract of sale of ascertained specified goods had an insurable interest in the goods in North Carolina under prior law.

If something remained to be done to the goods, or they were not specifically identified or ascertained, title remained in the seller. See *Blakely v. Patrick*, 67 N.C. 40 (1872). In such case the seller, and not the buyer, would have had the insurable interest in the goods. *Richardson v. Insurance Co. of North America*, 136 N.C. 314, 48 S.E. 733 (1904). A separation or marking of the goods would sufficiently identify them. See *Pitts v. Curtis*, 152 N.C. 615, 68 S.E. 189 (1910).

*Subsection (2)*, giving seller insurable interest, also accords with *King v. National Union Fire Ins. Co.*, 258 N.C. 432, 128 S.E.2d 849 (1962). So long as the seller has a pecuniary interest in the goods, such as his seller's lien for the price, possible liability for negligence in their destruction, etc., he should have an insurable interest in the goods.

There is no real difference in results as to insurable interest as a consequence of adoption of the UCC. Under the UCC, as under prior insurance theory, the question

of whether title has or has not passed from the seller to the buyer need not be determined.

§ 25-2-502. **Buyer's right to goods on seller's insolvency.**—(1) Subject to subsection (2) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section [§ 25-2-501] may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Compare Sections 17, 18 and 19, Uniform Sales Act.

##### Purposes:

1. This section gives an additional right to the buyer as a result of identification of the goods to the contract in the manner provided in Section 2—501. The buyer is given a right to the goods on the seller's insolvency occurring within 10 days after he receives the first installment on their price.

2. The question of whether the buyer also acquires a security interest in identified goods and has rights to the goods when insolvency takes place after the ten-day period provided in this section depends upon compliance with the provisions of the Article on Secured Transactions (Article 9).

3. Subsection (2) is included to preclude the possibility of unjust enrichment which exists if the buyer were permitted to recover goods even though they were greatly superior in quality or quantity to that called for by the contract for sale.

##### Cross references:

Point 1: Sections 1—201 and 2—702.

Point 2: Article 9.

##### Definitional cross references:

"Buyer" Section 2—103.

"Conform" Section 2—106.

"Contract for sale" Section 2—106.

"Goods" Section 2—105.

"Insolvent" Section 1—201.

"Right" Section 1—201.

"Seller" Section 2—103.

#### NORTH CAROLINA COMMENT

There are no prior North Carolina statutes or decisions directly in point.

There is, however, one North Carolina case which reaches a result similar to the result that will be reached under subsection (1). *Teague v. Howard Grocery Store*, 175 N.C. 195, 95 S.E. 173 (1918), provides that a purchaser who contracts for specified goods which are not delivered by the seller, but which are in his possession when he makes an assignment for the benefit of creditors, becomes titleholder of the specified goods and can take possession of the

specified goods against the seller's creditors; that such does not constitute a preference.

The same result is applicable under the Code where all or part payment for identified goods has been made. The buyer is entitled to recover the goods themselves and is not relegated to a position of only a general creditor. Determination of title is not necessary under the Code.

There was no North Carolina parallel to subsection (2), either by statute or decision.

§ 25-2-503. **Manner of seller's tender of delivery.**—(1) Tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery. The manner, time and place for tender are determined by the agreement and this article, and in particular

(a) tender must be at a reasonable hour, and if it is of goods they must be kept available for the period reasonably necessary to enable the buyer to take possession; but



(b) unless otherwise agreed the buyer must furnish facilities reasonably suited to the receipt of the goods.

(2) Where the case is within the next section [§ 25-2-504] respecting shipment tender requires that the seller comply with its provisions.

(3) Where the seller is required to deliver at a particular destination tender requires that he comply with subsection (1) and also in any appropriate case tender documents as described in subsections (4) and (5) of this section.

(4) Where goods are in the possession of a bailee and are to be delivered without being moved

(a) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but

(b) tender to the buyer of a nonnegotiable document of title or of a written direction to the bailee to deliver is sufficient tender unless the buyer seasonably objects, and receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the nonnegotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

(5) Where the contract requires the seller to deliver documents

(a) he must tender all such documents in correct form, except as provided in this article with respect to bills of lading in a set (subsection (2) of § 25-2-323); and

(b) tender through customary banking channels is sufficient and dishonor of a draft accompanying the documents constitutes nonacceptance or rejection. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** See Sections 11, 19, 20, 43 (3) and (4), 46 and 51, Uniform Sales Act.

**Changes:** The general policy of the above sections is continued and supplemented but subsection (3) changes the rule of prior section 19(5) as to what constitutes a "destination" contract and subsection (4) incorporates a minor correction as to tender of delivery of goods in the possession of a bailee.

##### Purposes of changes:

1. The major general rules governing the manner of proper or due tender of delivery are gathered in this section. The term "tender" is used in this Article in two different senses. In one sense it refers to "due tender" which contemplates an offer coupled with a present ability to fulfill all the conditions resting on the tendering party and must be followed by actual performance if the other party shows himself ready to proceed. Unless the context unmistakably indicates otherwise this is the meaning of "tender" in this Article and the occasional addition of the word "due" is only for clarity and emphasis. At other times it is used to refer to an offer of goods or documents under a contract as if in fulfillment of its conditions even though there is a defect

when measured against the contract obligation. Used in either sense, however, "tender" connotes such performance by the tendering party as puts the other party in default if he fails to proceed in some manner.

2. The seller's general duty to tender and deliver is laid down in Section 2-301 and more particularly in Section 2-507. The seller's right to a receipt if he demands one and receipts are customary is governed by Section 1-205. Subsection (1) of the present section proceeds to set forth two primary requirements of tender: first, that the seller "put and hold conforming goods at the buyer's disposition" and, second, that he "give the buyer any notice reasonably necessary to enable him to take delivery."

In cases in which payment is due and demanded upon delivery the "buyer's disposition" is qualified by the seller's right to retain control of the goods until payment by the provision of this Article on delivery on condition. However, where the seller is demanding payment on delivery he must first allow the buyer to inspect the goods in order to avoid impairing his tender unless the contract for sale is on C.I.F., C.O.D., cash against documents or similar terms negating the privilege of inspection before payment.

In the case of contracts involving documents the seller can "put and hold conforming goods at the buyer's disposition" under subsection (1) by tendering documents which give the buyer complete control of the goods under the provisions of Article 7 on due negotiation.

3. Under paragraph (a) of subsection (1) usage of the trade and the circumstances of the particular case determine what is a reasonable hour for tender and what constitutes a reasonable period of holding the goods available.

4. The buyer must furnish reasonable facilities for the receipt of the goods tendered by the seller under subsection (1), paragraph (b). This obligation of the buyer is no part of the seller's tender.

5. For the purposes of subsections (2) and (3) there is omitted from this Article the rule under prior uniform legislation that a term requiring the seller to pay the freight or cost of transportation to the buyer is equivalent to an agreement by the seller to deliver to the buyer or at an agreed destination. This omission is with the specific intention of negating the rule, for under this Article the "shipment" contract is regarded as the normal one and the "destination" contract as the variant type. The seller is not obligated to deliver at a named destination and bear the concurrent risk of loss until arrival, unless he has specifically agreed so to deliver or the commercial understanding of the terms used by the parties contemplates such delivery.

6. Paragraph (a) of subsection (4) continues the rule of the prior uniform legislation as to acknowledgment by the bailee. Paragraph (b) of subsection (4) adopts the rule that between the buyer and the seller the risk of loss remains on the seller during a period reasonable for securing acknowledgment of the transfer from the bailee, while as against all other parties the buyer's rights are fixed as of the time the bailee receives notice of the transfer.

7. Under subsection (5) documents are never "required" except where there is an express contract term or it is plainly im-

plicit in the peculiar circumstances of the case or in a usage of trade. Documents may, of course, be "authorized" although not required, but such cases are not within the scope of this subsection. When documents are required, there are three main requirements of this subsection: (1) "All": each required document is essential to a proper tender; (2) "Such": the documents must be the ones actually required by the contract in terms of source and substance; (3) "Correct form": All documents must be in correct form.

When a prescribed document cannot be procured, a question of fact arises under the provision of this Article on substituted performance as to whether the agreed manner of delivery is actually commercially impracticable and whether the substitute is commercially reasonable.

#### Cross references:

Point 2: Sections 1—205, 2—301, 2—310, 2—507 and 2—513 and Article 7.

Point 5: Sections 2—308, 2—310 and 2—509.

Point 7: Section 2—614(1).

Specific matters involving tender are covered in many additional sections of this Article. See Sections 1—205, 2—301, 2—306 to 2—319, 2—321(3), 2—504, 2—507(2), 2—511(1), 2—513, 2—612 and 2—614.

#### Definitional cross references:

"Agreement". Section 1—201.

"Bill of lading". Section 1—201.

"Buyer". Section 2—103.

"Conforming". Section 2—106.

"Contract". Section 1—201.

"Delivery". Section 1—201.

"Dishonor". Section 3—508.

"Document of title". Section 1—201.

"Draft". Section 3—104.

"Goods". Section 2—105.

"Notification". Section 1—201.

"Reasonable time". Section 1—204.

"Receipt" of goods. Section 2—103.

"Rights". Section 1—201.

"Seasonably". Section 1—204.

"Seller". Section 2—103.

"Written". Section 1—201.

### NORTH CAROLINA COMMENT

The first sentence of subsection (1) apparently accords with prior North Carolina law. See *Williams v. Johnston*, 26 N.C. 233 (1844), that the seller has the duty to notify the buyer when delivery will take place when the time for delivery is not set out in the contract.

Subsections (1) (a) and (b), defining

the time and place for tender have no North Carolina parallels, although proper tender for purposes of the NIL was set out in GS 25-78 et seq.

The remaining subsections setting out the details required for valid tender have no counterparts in prior North Carolina law and are therefore new.

**§ 25-2-504. Shipment by seller.**—Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then unless otherwise agreed he must

(a) put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case; and

(b) obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and

(c) promptly notify the buyer of the shipment.

Failure to notify the buyer under paragraph (c) or to make a proper contract under paragraph (a) is a ground for rejection only if material delay or loss ensues. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 46, Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To continue the general policy of the prior uniform statutory provision while incorporating certain modifications with respect to the requirement that the contract with the carrier be made expressly on behalf of the buyer and as to the necessity of giving notice of the shipment to the buyer, so that:

1. The section is limited to "shipment" contracts as contrasted with "destination" contracts or contracts for delivery at the place where the goods are located. The general principles embodied in this section cover the special cases of F. O. B. point of shipment contracts and C. I. F. and C. & F. contracts. Under the preceding section on manner of tender of delivery, due tender by the seller requires that he comply with the requirements of this section in appropriate cases.

2. The contract to be made with the carrier under paragraph (a) must conform to all express terms of the agreement, subject to any substitution necessary because of failure of agreed facilities as provided in the later provision on substituted performance. However, under the policies of this Article on good faith and commercial standards and on buyer's rights on improper delivery, the requirements of explicit provisions must be read in terms of their commercial and not their literal meaning. This policy is made express with respect to bills of lading in a set in the provision of this Article on form of bills of lading required in overseas shipment.

3. In the absence of agreement, the provision of this Article on options and co-operation respecting performance gives the seller the choice of any reasonable carrier, routing and other arrangements. Whether or not the shipment is at the buyer's expense the seller must see to any arrangements, reasonable in the circumstances,

such as refrigeration, watering of livestock, protection against cold, the sending along of any necessary help, selection of specialized cars and the like for paragraph (a) is intended to cover all necessary arrangements whether made by contract with the carrier or otherwise. There is, however, a proper relaxation of such requirements if the buyer is himself in a position to make the appropriate arrangements and the seller gives him reasonable notice of the need to do so. It is an improper contract under paragraph (a) for the seller to agree with the carrier to a limited valuation below the true value and thus cut off the buyer's opportunity to recover from the carrier in the event of loss, when the risk of shipment is placed on the buyer by his contract with the seller.

4. Both the language of paragraph (b) and the nature of the situation it concerns indicate that the requirement that the seller must obtain and deliver promptly to the buyer in due form any document necessary to enable him to obtain possession of the goods is intended to cumulate with the other duties of the seller such as those covered in paragraph (a).

In this connection, in the case of pool car shipments a delivery order furnished by the seller on the pool car consignee, or on the carrier for delivery out of a larger quantity, satisfies the requirements of paragraph (b) unless the contract requires some other form of document.

5. This Article, unlike the prior uniform statutory provision, makes it the seller's duty to notify the buyer of shipment in all cases. The consequences of his failure to do so, however, are limited in that the buyer may reject on this ground only where material delay or loss ensues.

A standard and acceptable manner of notification in open credit shipments is the sending of an invoice and in the case of documentary contracts is the prompt



forwarding of the documents as under paragraph (b) of this section. It is also usual to send on a straight bill of lading but this is not necessary to the required notification. However, should such a document prove necessary or convenient to the buyer, as in the case of loss and claim against the carrier, good faith would require the seller to send it on request.

Frequently the agreement expressly requires prompt notification as by wire or cable. Such a term may be of the essence and the final clause of paragraph (c) does not prevent the parties from making this a particular ground for rejection. To have this vital and irreparable effect upon the seller's duties, such a term should be part of the "dickered" terms written in any "form," or should otherwise be called seasonably and sharply to the seller's attention.

6. Generally, under the final sentence of the section, rejection by the buyer is justified only when the seller's dereliction

as to any of the requirements of this section in fact is followed by material delay or damage. It rests on the seller, so far as concerns matters not within the peculiar knowledge of the buyer, to establish that his error has not been followed by events which justify rejection.

#### Cross references:

Point 1: Sections 2—319, 2—320 and 2—503(2).

Point 2: Sections 1—203, 2—323(2), 2—601 and 2—614(1).

Point 3: Section 2—311(2).

Point 5: Section 1—203.

#### Definitional cross references:

"Agreement". Section 1—201.

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Delivery". Section 1—201.

"Goods". Section 2—105.

"Notifies". Section 1—201.

"Seller". Section 2—103.

"Send". Section 1—201.

"Usage of trade". Section 1—205.

### NORTH CAROLINA COMMENT

*Subsection (a)* accords with prior North Carolina law that if seller is to ship goods but no carrier is designated, it is the duty of the seller to ship in a reasonable course of transit. See *G. Ober & Son v. Smith*, 78 N.C. 313 (1878).

*Subsection (b)*, however, does not accord with *G. Ober & Son v. Smith*, 78 N.C. 313 (1878), which states that bills of lading or other documentary indicia of title need not be sent by the seller to the purchaser.

*Subsection (c)* also does not accord with prior North Carolina law as set out in *G. Ober & Son v. Smith*, 78 N.C. 313 (1878). That case held that it was not necessary for the seller to give notice of the shipment in order to shift title and the risk of loss to the buyer.

This section changes North Carolina law but not in any significant way that will vary commercial practice.

**§ 25-2-505. Seller's shipment under reservation.** — (1) Where the seller has identified goods to the contract by or before shipment:

(a) his procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named.

(b) a nonnegotiable bill of lading to himself or his nominee reserves possession of the goods as security but except in a case of conditional delivery (subsection (2) of § 25-2-507) a nonnegotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession of the bill of lading.

(2) When shipment by the seller with reservation of a security interest is in violation of the contract for sale it constitutes an improper contract for transportation within the preceding section [§ 25-2-504] but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's powers as a holder of a negotiable document. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

Prior uniform statutory provision: Section 20(2), (3), (4), Uniform Sales Act.

Changes: Completely rephrased, the "powers" of the parties in cases of reserva-

tion being emphasized primarily rather than the "rightfulness" of reservation.

Purposes of changes: To continue in general the policy of the prior uniform

statutory provision with certain modifications of emphasis and language, so that:

1. The security interest reserved to the seller under subsection (1) is restricted to securing payment or performance by the buyer and the seller is strictly limited in his disposition and control of the goods as against the buyer and third parties. Under this Article, the provision as to the passing of interest expressly applies "despite any reservation of security title" and also provides that the "rights, obligations and remedies" of the parties are not altered by the incidence of title generally. The security interest, therefore, must be regarded as a means given to the seller to enforce his rights against the buyer which is unaffected by and in turn does not affect the location of title generally. The rules set forth in subsection (1) are not to be altered by any apparent "contrary intent" of the parties as to passing of title, since the rights and remedies of the parties to the contract of sale, as defined in this Article, rest on the contract and its performance or breach and not on stereotyped presumptions as to the location of title.

This Article does not attempt to regulate local procedure in regard to the effective maintenance of the seller's security interest when the action is in replevin by the buyer against the carrier.

2. Every shipment of identified goods under a negotiable bill of lading reserves a security interest in the seller under subsection (1) paragraph (a).

It is frequently convenient for the seller to make the bill of lading to the order of a nominee such as his agent at destination, the financing agency to which he expects to negotiate the document or the bank issuing a credit to him. In many instances, also, the buyer is made the order party. This Article does not deal directly with the question as to whether a bill of lading made out by the seller to the order of a nominee gives the carrier notice of any rights which the nominee may have so as to limit its freedom or obligation to honor the bill of lading in the hands of the seller as the original shipper if the expected negotiation fails. This is dealt with in the Article on Documents of Title (Article 7).

3. A non-negotiable bill of lading taken to a party other than the buyer under subsection (1) paragraph (b) reserves possession of the goods as security in the seller but if he seeks to withhold the goods improperly the buyer can tender payment and recover them.

4. In the case of a shipment by non-negotiable bill of lading taken to a buyer, the seller, under subsection (1) retains no security interest or possession as against the buyer and by the shipment he *de facto* loses control as against the carrier except where he rightfully and effectively stops delivery in transit. In cases in which the contract gives the seller the right to payment against delivery, the seller, by making an immediate demand for payment, can show that his delivery is conditional, but this does not prevent the buyer's power to transfer full title to a sub-buyer in ordinary course or other purchaser under Section 2—403.

5. Under subsection (2) an improper reservation by the seller which would constitute a breach in no way impairs such of the buyer's rights as result from identification of the goods. The security title reserved by the seller under subsection (1) does not protect his holding of the document or the goods for the purpose of exacting more than is due him under the contract.

#### Cross references:

Point 1: Section 1—201.

Point 2: Article 7.

Point 3: Sections 2—501(2) and 2—504.

Point 4: Sections 2—403, 2—507(2) and 2—705.

Point 5: Sections 2—310, 2—319(4), 2—320(4), 2—501 and 2—502 and Article 7.

#### Definitional cross references:

"Bill of lading". Section 1—201.

"Buyer". Section 2—103.

"Consignee". Section 7—102.

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Delivery". Section 1—201.

"Financing agency". Section 2—104.

"Goods". Section 2—105.

"Holder". Section 1—201.

"Person". Section 1—201.

"Security interest". Section 1—201.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

Under prior North Carolina law procurement by seller of a bill of lading in his own name or to his own order reserved title in the seller until the draft attached thereto was paid. *Early & Daniels Co. v. Aulander Flour Mills*, 187 N.C. 344, 121 S.E. 539 (1924). Title was not

merely for security purposes but included risk of loss which followed title. See *Periman v. Winder*, 180 N.C. 73, 103 S.E. 908 (1920).

This section therefore changes North bill of lading made to himself or to his Carolina law. If seller shipped and had

own order, legal title did not pass to the buyer for any purpose (such as risk of loss). Under the UCC, however, by making the bill of lading to his own order, or to the order of one other than the buyer, the seller does not retain legal title to goods shipped, but retains only a "security interest." If goods are destroyed, the risk of loss falls on buyer if the goods conformed. In North Carolina the risk of loss

formerly would have fallen on the seller if the bill of lading was to his own order.

Subsection (2) accords with *Riley v. Carpenter*, 143 N.C. 215, 55 S.E. 628 (1906), that if shipment with reservation of title in seller violates terms of contract, because bill of lading is made out to the order of the seller and not the buyer, it constitutes a breach.

**§ 25-2-506. Rights of financing agency.**—(1) A financing agency by paying or purchasing for value a draft which relates to a shipment of goods acquires to the extent of the payment or purchase and in addition to its own rights under the draft and any document of title securing it any rights of the shipper in the goods including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

(2) The right to reimbursement of a financing agency which has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by subsequent discovery of defects with reference to any relevant document which was apparently regular on its face. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

Prior uniform statutory provision: None.  
Purposes:

1. "Financing agency" is broadly defined in this Article to cover every normal instance in which a party aids or intervenes in the financing of a sales transaction. The term as used in subsection (1) is not in any sense intended as a limitation and covers any other appropriate situation which may arise outside the scope of the definition.

2. "Paying" as used in subsection (1) is typified by the letter of credit, or "authority to pay" situation in which a banker, by arrangement with the buyer or other consignee, pays on his behalf a draft for the price of the goods. It is immaterial whether the draft is formally drawn on the party paying or his principal, whether it is a sight draft paid in cash or a time draft "paid" in the first instance by acceptance, or whether the payment is viewed as absolute or conditional. All of these cases constitute "payment" under this subsection. Similarly, "purchasing for value" is used to indicate the whole area of financing by the seller's banker, and the principle of subsection (1) is applicable without any niceties of distinction between "purchase," "discount," "advance against collection" or the like. But it is important to notice that the only right to have the draft honored that is acquired is that *against the buyer*; if any right against any one else is claimed it will have to be under some separate obligation of that other person. A letter of credit does not necessarily protect *purchasers* of drafts. See Article 5. And for the relations of the parties to documentary drafts see Part 5 of Article 4.

3. Subsection (1) is made applicable to payments or advances against a draft which "relates to" a shipment of goods and this has been chosen as a term of maximum breadth. In particular the term is intended to cover the case of a draft against an invoice or against a delivery order. Further, it is unnecessary that there be an explicit assignment of the invoice attached to the draft to bring the transaction within the reason of this subsection.

4. After shipment, "the rights of the shipper in the goods" are merely security rights and are subject to the buyer's right to force delivery upon tender of the price. The rights acquired by the financing agency are similarly limited and, moreover, if the agency fails to procure any outstanding negotiable document of title, it may find its exercise of these rights hampered or even defeated by the seller's disposition of the document to a third party. This section does not attempt to create any new rights in the financing agency against the carrier which would force the latter to honor a stop order from the agency, a stranger to the shipment, or any new rights against a holder to whom a document of title has been duly negotiated under Article 7.

#### Cross references:

Point 1: Section 2—104 (2) and Article 4.

Point 2: Part 5 of Article 4, and Article 5.

Point 4: Sections 2—501 and 2—502(1) and Article 7.

#### Definitional cross references:

"Buyer". Section 2—103.



"Document of title". Section 1—201.  
 "Draft". Section 3—104.  
 "Financing agency" Section 2—104.  
 "Good faith". Section 2—103.  
 "Goods". Section 2—105.

"Honor". Section 1—201.  
 "Purchase". Section 1—201.  
 "Rights". Section 1—201.  
 "Value". Section 1—201.

#### NORTH CAROLINA COMMENT

There is no statutory or case law exactly in point. While under prior North Carolina law a bank or financing agency could purchase a bill of lading by discounting draft attached and receive seller's title, the UCC by subsection (1) of this section gives the financing agency in such case only a "security interest."

Subsection (2) follows the policy of the Uniform Bills of Lading Act, GS 21-37, in freeing a person who enters transaction merely as a financier from responsibility for defects in the documents of title or the merchandise therein described. See *Mason v. A. E. Nelson Cotton Co.*, 148 N.C. 492, 62 S.E. 625 (1908).

**§ 25-2-507. Effect of seller's tender; delivery on condition.—**  
 (1) Tender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract.

(2) Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** See Sections 11, 41, 42 and 69, Uniform Sales Act.

##### Purposes:

1. Subsection (1) continues the policies of the prior uniform statutory provisions with respect to tender and delivery by the seller. Under this Article the same rules in these matters are applied to present sales and to contracts for sale. But the provisions of this subsection must be read within the framework of the other sections of this Article which bear upon the question of delivery and payment.

2. The "unless otherwise agreed" provision of subsection (1) is directed primarily to cases in which payment in advance has been promised or a letter of credit term has been included. Payment "according to the contract" contemplates immediate payment, payment at the end of an agreed credit term, payment by a time acceptance or the like. Under this Act, "contract" means the total obligation in law which results from the parties' agreement including the effect of this Article. In this context, therefore, there must be considered the effect in law of such provisions as those on means and manner of payment and on failure of agreed means and manner of payment.

3. Subsection (2) deals with the effect of a conditional delivery by the seller and in such a situation makes the buyer's "right as against the seller" conditional upon payment. These words are used as words of limitation to conform with the policy set forth in the bona fide purchase sections of this Article. Should the seller after making such a conditional delivery fail to follow up his rights, the condition is waived. The provision of this Article for a ten day limit within which the seller may reclaim goods delivered on credit to an insolvent buyer is also applicable here.

##### Cross references:

Point 1: Sections 2—310, 2—503, 2—511, 2—601 and 2—711 to 2—713.

Point 2: Sections 1—201, 2—511 and 2—614.

Point 3: Sections 2—401, 2—403 and 2—702(1) (b)

##### Definitional cross references:

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Delivery". Section 1—201.

"Document of title". Section 1—201.

"Goods". Section 2—105.

"Rights". Section 1—201.

"Seller". Section 2—103.

#### NORTH CAROLINA COMMENT

*Subsection (1)* accords with the general law of contracts that in the absence of contrary agreement, payment and delivery are concurrent conditions. See *McAden v. Craig*, 222 N.C. 497, 24 S.E.2d 1 (1942);

*Wessel v. Seminole Phosphate Co.*, 13 F.2d 999 (4th Cir. 1926).

*Subsection (2)* has no statutory or decisional parallel in the prior law of sales.

**§ 25-2-508. Cure by seller of improper tender or delivery; replacement.**—(1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a nonconforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

Prior uniform statutory provision: None.

##### Purposes:

1. Subsection (1) permits a seller who has made a non-conforming tender in any case to make a conforming delivery within the contract time upon seasonable notification to the buyer. It applies even where the seller has taken back the non-conforming goods and refunded the purchase price. He may still make a good tender within the contract period. The closer, however, it is to the contract date, the greater is the necessity for extreme promptness on the seller's part in notifying of his intention to cure, if such notification is to be "seasonable" under this subsection.

The rule of this subsection, moreover, is qualified by its underlying reasons. Thus if, after contracting for June delivery a buyer later makes known to the seller his need for shipment early in the month and the seller ships accordingly, the "contract time" has been cut down by the supervening modification and the time for cure of tender must be referred to this modified time term.

2. Subsection (2) seeks to avoid injustice to the seller by reason of a surprise rejection by the buyer. However, the seller is not protected unless he had "reasonable grounds to believe" that the tender would be acceptable. Such reasonable grounds can lie in prior course of dealing, course of performance or usage of trade as well as in the particular circumstances surrounding the making of the contract. The seller is charged with commercial knowledge of any factors in a particular sales situation which require him to comply strictly with his obligations under the contract as, for example, strict conformity of

documents in an overseas shipment or the sale of precision parts or chemicals for use in manufacture. Further, if the buyer gives notice either implicitly, as by a prior course of dealing involving rigorous inspections, or expressly, as by the deliberate inclusion of a "no replacement" clause in the contract, the seller is to be held to rigid compliance. If the clause appears in a "form" contract evidence that it is out of line with trade usage or the prior course of dealing and was not called to the seller's attention may be sufficient to show that the seller had reasonable grounds to believe that the tender would be acceptable.

3. The words "a further reasonable time to substitute a conforming tender" are intended as words of limitation to protect the buyer. What is a "reasonable time" depends upon the attending circumstances. Compare Section 2-511 on the comparable case of a seller's surprise demand for legal tender.

4. Existing trade usages permitting variations without rejection but with price allowance enter into the agreement itself as contractual limitations of remedy and are not covered by this section.

##### Cross references:

Point 2: Section 2-302.

Point 3: Section 2-511.

Point 4: Sections 1-205 and 2-721.

##### Definitional cross references:

"Buyer". Section 2-103.

"Conforming". Section 2-106.

"Contract". Section 1-201.

"Money". Section 1-201.

"Notifies". Section 1-201.

"Reasonable time". Section 1-204.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

#### NORTH CAROLINA COMMENT

This section has no counterpart in prior North Carolina statutory or decisional law.

**§ 25-2-509. Risk of loss in the absence of breach.**—(1) Where the contract requires or authorizes the seller to ship the goods by carrier

(a) if it does not require him to deliver them at a particular destination, the risk

of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (§ 25-2-505); but

(b) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.

(2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer

(a) on his receipt of a negotiable document of title covering the goods; or

(b) on acknowledgment by the bailee of the buyer's right to possession of the goods; or

(c) after his receipt of a nonnegotiable document of title or other written direction to deliver, as provided in subsection (4) (b) of § 25-2-503.

(3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery.

(4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this article on sale on approval (§ 25-2-327) and on effect of breach on risk of loss (§ 25-2-510). (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 22. Uniform Sales Act.

**Changes:** Rewritten, subsection (3) of this section modifying prior law.

**Purposes of changes:** To make it clear that:

1. The underlying theory of these sections on risk of loss is the adoption of the contractual approach rather than an arbitrary shifting of the risk with the "property" in the goods. The scope of the present section, therefore, is limited strictly to those cases where there has been no breach by the seller. Where for any reason his delivery or tender fails to conform to the contract, the present section does not apply and the situation is governed by the provisions on effect of breach on risk of loss.

2. The provisions of subsection (1) apply where the contract "requires or authorizes" shipment of the goods. This language is intended to be construed parallel to comparable language in the section on shipment by seller. In order that the goods be "duly delivered to the carrier" under paragraph (a) a contract must be entered into with the carrier which will satisfy the requirements of the section on shipment by the seller and the delivery must be made under circumstances which will enable the seller to take any further steps necessary to a due tender. The underlying reason of this subsection does not require that the shipment be made after contracting, but where, for example, the seller buys the goods afloat and later diverts the shipment to the buyer, he must identify the goods to the contract before the risk of loss can pass. To transfer the

risk it is enough that a proper shipment and a proper identification come to apply to the same goods although, aside from special agreement, the risk will not pass retroactively to the time of shipment in such a case.

3. Whether the contract involves delivery at the seller's place of business or at the situs of the goods, a merchant seller cannot transfer risk of loss and it remains upon him until actual receipt by the buyer, even though full payment has been made and the buyer has been notified that the goods are at his disposal. Protection is afforded him, in the event of breach by the buyer, under the next section.

The underlying theory of this rule is that a merchant who is to make physical delivery at his own place continues meanwhile to control the goods and can be expected to insure his interest in them. The buyer, on the other hand, has no control of the goods and it is extremely unlikely that he will carry insurance on goods not yet in his possession.

4. Where the agreement provides for delivery of the goods as between the buyer and seller without removal from the physical possession of a bailee, the provisions on manner of tender of delivery apply on the point of transfer of risk. Due delivery of a negotiable document of title covering the goods or acknowledgment by the bailee that he holds for the buyer completes the "delivery" and passes the risk.

5. The provisions of this section are made subject by subsection (4) to the "contrary agreement" of the parties. This



language is intended as the equivalent of the phrase "unless otherwise agreed" used more frequently throughout this Act. "Contrary" is in no way used as a word of limitation and the buyer and seller are left free to readjust their rights and risks as declared by this section in any manner agreeable to them. Contrary agreement can also be found in the circumstances of the case, a trade usage or practice, or a course of dealing or performance.

**Cross references:**

Point 1: Section 2—510(1).

Point 2: Sections 2—503 and 2—504.

Point 3: Sections 2—104, 2—503 and 2—510.

Point 4: Section 2—503(4)

Point 5: Section 1—201.

**Definitional cross references:**

"Agreement" Section 1—201.

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Delivery". Section 1—201.

"Document of title". Section 1—201.

"Goods". Section 2—105.

"Merchant". Section 2—104.

"Party". Section 1—201.

"Receipt" of goods. Section 2—103.

"Sale on approval" Section 2—326.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

The prior law provided that risk of loss followed the title. *Penniman v. Winder*, 180 N.C. 73, 103 S.E. 908 (1920); *Early & Daniels Co. v. Aulander Flour Mills*, 187 N.C. 344, 121 S.E. 539 (1924); *Richardson v. Insurance Co. of North America*, 136 N.C. 314, 48 S.E. 733 (1904).

This section of the UCC abolishes the traditional "property passage" or "title" approach as regards the question of who bears the risk of loss. Under the Code it is not necessary to make a broad and circuitous search to locate title to determine risk of loss. This Code section provides a direct mode of determining who has the risk of loss by short and concise statements. In most cases the results are the same under both methods.

*Subsection (1) (a)* provides that if the contract does not require the seller to deliver to a particular destination, risk of loss passes to the buyer when the goods are delivered to the carrier. This accords with the prior North Carolina rule. See *Hunter v. Randolph*, 128 N.C. 91, 38 S.E. 288 (1901).

But subsection (1) (a) provides that the risk of loss passes to the buyer even if the shipment is under reservation (by reservation of security via bill of lading made to order of seller). This does not accord with prior North Carolina law which held that if seller had procured a bill of lading to seller's order, no title passed by shipment of the goods until the draft accompanying the bill of lading was paid. Thus, if the bill of lading, upon shipment, was made "to seller's order" risk of loss was on the seller. See *Early & Daniels Co. v. Aulander Flour Mills*, 187 N.C. 344, 121 S.E. 539 (1924). *Contra*, Uniform Sales Act, § 20 (2) but North Carolina never adopted the Uniform Sales Act.

*Subsection (1) (b)* provides that if the contract requires seller to deliver to a particular destination, the goods remain at the seller's risk until they reach their destination. Mere delivery to the carrier does not shift the risk of loss to the buyer. This accords with *Peed v. Burleson's, Inc.*, 244 N.C. 437, 94 S.E.2d 351 (1956). Title remains in the seller until delivery (or tender of delivery) at the rightful place to the buyer. *Acme Paper Box Factory v. Atlantic Coast Line R.R.*, 148 N.C. 421, 62 S.E. 557 (1908). Subsection (1) (b) thus accords with the North Carolina cases in result.

*Subsections (2) (a) and (b)* provide that risk of loss shall shift if goods are held by bailee and buyer receives documents of title covering goods or bailee acknowledges buyer's right to possess the goods. Compare *Williams v. Hodges*, 113 N.C. 36, 18 S.E. 83 (1893); *Waldo v. Belcher*, 33 N.C. 609 (1850); on contract for sale of specific goods, property was transferred unless different intention appears, when contract was made. See *Winborne v. McMahon*, 206 N.C. 30, 173 S.E. 278 (1934); *Teague v. Howard Grocery Store*, 175 N.C. 195, 95 S.E. 173 (1918). This would appear to put prior North Carolina law substantially in accord with subsections (2) (a) and (b).

*Subsection (3)* provides that if seller is "merchant," risk of loss does not pass to buyer until receipt of the goods. If seller is not merchant, risk passes to buyer only upon tender of delivery. This constitutes a basic change in North Carolina law, differentiating merchant sellers from others.

Under prior North Carolina law, risk followed title. On a contract for sale of specific goods title passed when the contract was made. *Winborne v. McMahon*,

206 N.C. 30, 173 S.E. 278 (1934). On making a contract for specific goods, identified without more for the seller to do, the buyer then had the risk of loss after the contract. This Code provision shifts risk of loss to seller until either receipt of the goods by the buyer or until tender of de-

livery by the seller. It is thought that this accords more with lay understanding and practice. In addition the seller is likely to be better covered with insurance. The search for title is entirely obviated.

*Subsection (4)* allows the parties to contract to change risk of loss.

**§ 25-2-510. Effect of breach on risk of loss.**—(1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance.

(2) Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

(3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** To make clear that:

1. Under subsection (1) the seller by his individual action cannot shift the risk of loss to the buyer unless his action conforms with all the conditions resting on him under the contract.

2. The "cure" of defective tenders contemplated by subsection (1) applies only to those situations in which the seller makes changes in goods already tendered, such as repair, partial substitution, sorting out from an improper mixture and the like since "cure" by repossession and new tender has no effect on the risk of loss of the goods originally tendered. The seller's privilege of cure does not shift the risk, however, until the cure is completed.

Where defective documents are involved a cure of the defect by the seller or a waiver of the defects by the buyer will operate to shift the risk under this section. However, if the goods have been destroyed prior to the cure or the buyer is unaware of their destruction at the time he waives the defect in the documents, the risk of the loss must still be borne by the seller, for the risk shifts only at the time of cure,

waiver of documentary defects or acceptance of the goods.

3. In cases where there has been a breach of the contract, if the one in control of the goods is the aggrieved party, whatever loss or damage may prove to be uncovered by his insurance falls upon the contract breaker under subsections (2) and (3) rather than upon him. The word "effective" as applied to insurance coverage in those subsections is used to meet the case of supervening insolvency of the insurer. The "deficiency" referred to in the text means such deficiency in the insurance coverage as exists without subrogation. This section merely distributes the risk of loss as stated and is not intended to be disturbed by any subrogation of an insurer.

**Cross reference:**

Section 2—509.

**Definitional cross references:**

"Buyer". Section 2—103.

"Conform". Section 2—106.

"Contract for sale" Section 2—106.

"Goods". Section 2—105.

"Seller". Section 2—103.

#### NORTH CAROLINA COMMENT

*Subsection (1)* placing the risk of loss on the seller if goods do not conform accords in result with prior North Carolina law which allowed a right of rescission or rejection for noncompliance of the goods to the contract. See *Hendrix v. B & L Motors, Inc.*, 241 N.C. 644, 86 S.E.2d 448 (1955). This would seem to have entitled the buyer to reshift the risk of loss

if the goods did not conform to contract as is the effect of this UCC provision.

*Subsections (2) and (3)* have no statutory or decisional parallels in North Carolina, except that in North Carolina the risk of loss would have been on the buyer if the buyer repudiated contract even though the goods conformed to the terms of the contract.

**§ 25-2-511. Tender of payment by buyer; payment by check.—**

(1) Unless otherwise agreed tender of payment is a condition to the seller's duty to tender and complete any delivery.

(2) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

(3) Subject to the provisions of this chapter on the effect of an instrument on an obligation (§ 25-3-802), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 42, Uniform Sales Act.

**Changes:** Rewritten by this section and Section 2—507.

**Purposes of changes:**

1. The requirement of payment against delivery in subsection (1) is applicable to noncommercial sales generally and to ordinary sales at retail although it has no application to the great body of commercial contracts which carry credit terms. Subsection (1) applies also to documentary contracts in general and to contracts which look to shipment by the seller but contain no term on time and manner of payment, in which situations the payment may, in proper case, be demanded against delivery of appropriate documents.

In the case of specific transactions such as C.O.D. sales or agreements providing for payment against documents, the provisions of this subsection must be considered in conjunction with the special sections of the Article dealing with such terms. The provision that tender of payment is a condition to the seller's duty to tender and complete "any delivery" integrates this section with the language and policy of the section on delivery in several lots which call for separate payment. Finally, attention should be directed to the provision on right to adequate assurance of performance which recognizes, even before the time for tender, an obligation on the buyer not to impair the seller's expectation of receiving payment in due course.

2. Unless there is agreement otherwise the concurrence of the conditions as to tender of payment and tender of delivery requires their performance at a single place or time. This Article determines that place and time by determining in various other sections the place and time for tender of delivery under various circumstances and in particular types of transactions. The sections dealing with time and place of delivery together with the section on right to inspection of goods answer the subsidiary question as to when payment

may be demanded before inspection by the buyer.

3. The essence of the principle involved in subsection (2) is avoidance of commercial surprise at the time of performance. The section on substituted performance covers the peculiar case in which legal tender is not available to the commercial community.

4. Subsection (3) is concerned with the rights and obligations as between the parties to a sales transaction when payment is made by check. This Article recognizes that the taking of a seemingly solvent party's check is commercially normal and proper and, if due diligence is exercised in collection, is not to be penalized in any way. The conditional character of the payment under this section refers only to the effect of the transaction "as between the parties" thereto and does not purport to cut into the law of "absolute" and "conditional" payment as applied to such other problems as the discharge of sureties or the responsibilities of a drawee bank which is at the same time an agent for collection.

The phrase "by check" includes not only the buyer's own but any check which does not effect a discharge under Article 3 (Section 3—802). Similarly the reason of this subsection should apply and the same result should be reached where the buyer "pays" by sight draft on a commercial firm which is financing him.

5. Under subsection (3) payment by check is defeated if it is not honored upon due presentment. This corresponds to the provisions of the Article on Commercial Paper. (Section 3—802). But if the seller procures certification of the check instead of cashing it, the buyer is discharged. (Section 3—411).

6. Where the instrument offered by the buyer is not a payment but a credit instrument such as a note or a check postdated by even one day, the seller's acceptance of the instrument insofar as third parties are concerned, amounts to a delivery on credit and his remedies are set forth in the section on buyer's insolvency. As be-



tween the buyer and the seller, however, the matter turns on the present subsection and the section on conditional delivery and subsequent dishonor of the instrument gives the seller rights on it as well as for breach of the contract for sale.

**Cross references:**

Point 1: Sections 2—307, 2—310, 2—320, 2—325, 2—503, 2—513 and 2—609.

Point 2: Sections 2—307, 2—310, 2—319, 2—322, 2—503, 2—504 and 2—513.

Point 3: Section 2—614.

Point 5: Article 3, esp. Sections 3—802 and 3—411.

Point 6: Sections 2—507, 2—702, and Article 3.

**Definitional cross references:**

“Buyer”. Section 2—103.

“Check”. Section 3—104.

“Dishonor”. Section 3—508.

“Party”. Section 1—201.

“Reasonable time”. Section 1—204.

“Seller”. Section 2—103.

### NORTH CAROLINA COMMENT

*Subsection (1)* makes tender of payment by the buyer a condition precedent to seller's duty to deliver. The Code requires the buyer to do the first act. Prior North Carolina law made the payment of money and the delivery of property simultaneous or concurrent acts. See *McAden v. Craig*, 222 N.C. 497, 24 S.E.2d 1 (1942). *Hughes v. Knott*, 138 N.C. 105, 50 S.E. 586 (1905), said that payment of the price must be either precedent or concurrent to delivery.

*Subsection (2)* is in accord with *Hughes v. Knott*, 138 N.C. 105, 50 S.E. 586 (1942), which says that a custom of accepting checks as payment for goods in particular trades can be shown and if the check is refused as payment the buyer shall have a reasonable time to convert

his funds into currency and that this will be a valid tender of performance by the buyer.

*Subsection (3)*, which states that payment by check is only conditional, accords with prior North Carolina law. See *Weddington v. Boshamer*, 237 N.C. 556, 75 S.E.2d 530 (1953); *Central Nat'l Bank v. Rich*, 256 N.C. 324, 123 S.E.2d 811 (1961); *Carrow v. Weston*, 247 N.C. 735, 102 S.E.2d 134 (1958); *Wilson v. Commercial Fin. Co.*, 239 N.C. 349, 79 S.E.2d 908 (1953); *Handley Motor Co. v. Wood*, 237 N.C. 318, 75 S.E.2d 312 (1953), which hold that title does not pass by acceptance of check until it is paid by the bank on which it is drawn. The seller may reclaim goods sold to the buyer in case the check is not paid on due presentation.

§ 25-2-512. **Payment by buyer before inspection.**—(1) Where the contract requires payment before inspection nonconformity of the goods does not excuse the buyer from so making payment unless

(a) the nonconformity appears without inspection; or

(b) despite tender of the required documents the circumstances would justify injunction against honor under the provisions of this chapter (§ 25-5-114).

(2) Payment pursuant to subsection (1) does not constitute an acceptance of goods or impair the buyer's right to inspect or any of his remedies. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None, but see Sections 47 and 49, Uniform Sales Act.

**Purposes:**

1. Subsection (1) of the present section recognizes that the essence of a contract providing for payment before inspection is the intention of the parties to shift to the buyer the risks which would usually rest upon the seller. The basic nature of the transaction is thus preserved and the buyer is in most cases required to pay first and litigate as to any defects later.

2. “Inspection” under this section is an inspection in a manner reasonable for detecting defects in goods whose surface appearance is satisfactory.

3. Clause (a) of this subsection states an exception to the general rule based on common sense and normal commercial practice. The apparent non-conformity referred to is one which is evident in the mere process of taking delivery.

4. Clause (b) is concerned with contracts for payment against documents and incorporates the general clarification and modification of the case law contained in the section on excuse of a financing agency. Section 5—114

5. Subsection (2) makes explicit the general policy of the Uniform Sales Act that the payment required before inspection in no way impairs the buyer's remedies or rights in the event of a default by

the seller. The remedies preserved to the buyer are all of his remedies which include as a matter of reason the remedy for total non-delivery after payment in advance.

The provision on performance or acceptance under reservation of rights does not apply to the situations contemplated here in which payment is made in due course under the contract and the buyer need not pay "under protest" or the like in order to preserve his rights as to defects discovered upon inspection.

6. This section applies to cases in which the contract requires payment before inspection either by the express agreement of the parties or by reason of the effect in law of that contract. The present sec-

tion must therefore be considered in conjunction with the provision on right to inspection of goods which sets forth the instances in which the buyer is not entitled to inspection before payment.

**Cross references:**

Point 4: Article 5.

Point 5: Section 1—207.

Point 6: Section 2—513(3).

**Definitional cross references:**

"Buyer". Section 2—103.

"Conform". Section 2—106.

"Contract". Section 1—201.

"Financing agency". Section 2—104.

"Goods". Section 2—105.

"Remedy". Section 1—201.

"Rights". Section 1—201.

**NORTH CAROLINA COMMENT**

There is apparently no statutory or decisional law in North Carolina in relation to this section, but it seems to accord with

"common sense and normal commercial practice" and would probably have been the law in North Carolina.

**§ 25-2-513. Buyer's right to inspection of goods.**—(1) Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

(2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.

(3) Unless otherwise agreed and subject to the provisions of this article on C.I.F. contracts (subsection (3) of § 25-2-321), the buyer is not entitled to inspect the goods before payment of the price when the contract provides

(a) for delivery "C.O.D." or on other like terms; or

(b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.

(4) A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 47(2), (3), Uniform Sales Act.

**Changes:** Rewritten, subsections (2) and (3) being new.

**Purposes of changes and new matter:** To correspond in substance with the prior uniform statutory provision and to incorporate in addition some of the results of the better case law so that:

1. The buyer is entitled to inspect goods as provided in subsection (1) unless it has been otherwise agreed by the parties. The phrase "unless otherwise agreed" is intended principally to cover such situations

as those outlined in subsections (3) and (4) and those in which the agreement of the parties negates inspection before tender of delivery. However, no agreement by the parties can displace the entire right of inspection except where the contract is simply for the sale of "this thing." Even in a sale of boxed goods "as is" inspection is a right to the buyer, since if the boxes prove to contain some other merchandise altogether the price can be recovered back; nor do the limitations of the provision on effect of acceptance apply in such a case.

2. The buyer's right of inspection is available to him upon tender, delivery or appropriation of the goods with notice to him. Since inspection is available to him on tender, where payment is due against delivery he may, unless otherwise agreed, make his inspection before payment of the price. It is also available to him after receipt of the goods and so may be postponed after receipt for a reasonable time. Failure to inspect before payment does not impair the right to inspect after receipt of the goods unless the case falls within subsection (4) on agreed and exclusive inspection provisions. The right to inspect goods which have been appropriated with notice to the buyer holds whether or not the sale was by sample.

3. The buyer may exercise his right of inspection at any reasonable time or place and in any reasonable manner. It is not necessary that he select the most appropriate time, place or manner to inspect or that his selection be the customary one in the trade or locality. Any reasonable time, place or manner is available to him and the reasonableness will be determined by trade usages, past practices between the parties and the other circumstances of the case.

The last sentence of subsection (1) makes it clear that the place of arrival of shipped goods is a reasonable place for their inspection.

4. Expenses of an inspection made to satisfy the buyer of the seller's performance must be assumed by the buyer in the first instance. Since the rule provides merely for an allocation of expense there is no policy to prevent the parties from providing otherwise in the agreement. Where the buyer would normally bear the expenses of the inspection but the goods are rightly rejected because of what the inspection reveals, demonstrable and reasonable costs of the inspection are part of his incidental damage caused by the seller's breach.

5. In the case of payment against documents, subsection (3) requires payment before inspection, since shipping documents against which payment is to be made will commonly arrive and be tendered while the goods are still in transit.

This Article recognizes no exception in any peculiar case in which the goods happen to arrive before the documents. However, where by the agreement payment is to await the arrival of the goods, inspection before payment becomes proper since the goods are then "available for inspection."

Where by the agreement the documents are to be held until arrival the buyer is entitled to inspect before payment since the goods are then "available for inspection". Proof of usage is not necessary to establish this right, but if inspection before payment is disputed the contrary must be established by usage or by an explicit contract term to that effect.

For the same reason, that the goods are available for inspection, a term calling for payment against storage documents or a delivery order does not normally bar the buyer's right to inspection before payment under subsection (3) (b). This result is reinforced by the buyer's right under subsection (1) to inspect goods which have been appropriated with notice to him.

6. Under subsection (4) an agreed place or method of inspection is generally held to be intended as exclusive. However, where compliance with such an agreed inspection term becomes impossible, the question is basically one of intention. If the parties clearly intend that the method of inspection named is to be a necessary condition without which the entire deal is to fail, the contract is at an end if that method becomes impossible. On the other hand, if the parties merely seek to indicate a convenient and reliable method but do not intend to give up the deal in the event of its failure, any reasonable method of inspection may be substituted under this Article.

Since the purpose of an agreed place of inspection is only to make sure at that point whether or not the goods will be thrown back, the "exclusive" feature of the named place is satisfied under this Article if the buyer's failure to inspect there is held to be an acceptance with the knowledge of such defects as inspection would have revealed within the section on waiver of buyer's objections by failure to particularize. Revocation of the acceptance is limited to the situations stated in the section pertaining to that subject. The reasonable time within which to give notice of defects within the section on notice of breach begins to run from the point of the "acceptance."

7. Clauses on time of inspection are commonly clauses which limit the time in which the buyer must inspect and give notice of defects. Such clauses are therefore governed by the section of this Article which requires that such a time limitation must be reasonable.

8. Inspection under this Article is not to be regarded as a "condition precedent



to the passing of title" so that risk until inspection remains on the seller. Under subsection (4) such an approach cannot be sustained. Issues between the buyer and seller are settled in this Article almost wholly by special provisions and not by the technical determination of the locus of the title. Thus "inspection as a condition to the passing of title" becomes a concept almost without meaning. However, in peculiar circumstances inspection may still have some of the consequences hitherto sought and obtained under that concept.

9. "Inspection" under this section has to do with the buyer's check-up on whether the seller's performance is in accordance with a contract previously made and is not to be confused with the "examination" of the goods or of a sample or model of them at the time of contracting which may affect the warranties involved in the contract.

#### Cross references:

Generally: Sections 2—310 (b), 2—321(3) and 2—606(1) (b).

### NORTH CAROLINA COMMENT

*Subsection (1)*, giving buyer right to inspect goods, is in accord with *Parker v. Fenwick*, 138 N.C. 209, 50 S.E. 630 (1905), and *Standard Paint & Lead Works v. Spruill*, 186 N.C. 68, 118 S.E. 891 (1923). The latter case states: "Under an executory contract for the sale and delivery of goods of a specified quality, the quality is a part of the description, and the seller is bound to furnish goods actually complying with such description. If he tenders articles of inferior quality, the vendee is not bound to accept them, and unless he does so, he is not liable therefor. This necessarily gives to the vendee the right of inspection, and he must be given an opportunity to make such inspection before becoming liable for the

- Point 1: Section 2—607.
- Point 2: Sections 2—501 and 2—502.
- Point 4: Section 2—715.
- Point 5: Section 2—221(3).
- Point 6: Sections 2—606 to 2—608.
- Point 7: Section 1—204.
- Point 8: Comment to Section 2—401.
- Point 9: Section 2—316(2) (b).

#### Definitional cross references:

- "Buyer". Section 2—103.
- "Conform". Section 2—106.
- "Contract". Section 1—201.
- "Contract for sale". Section 2—106.
- "Document of title". Section 1—201.
- "Goods". Section 2—105.
- "Party". Section 1—201.
- "Presumed". Section 1—201.
- "Reasonable time". Section 1—204.
- "Rights". Section 1—201.
- "Seller". Section 2—103.
- "Send". Section 1—201.
- "Term". Section 1—201.

purchase price, unless the contract otherwise provides." "A vendee of merchandise shipped from a distant point, under a contract specifying the quality of the merchandise and providing for its delivery F.O.B. at the point of shipment, but which contains no provisions as to the time or place of payment, inspection or acceptance, is entitled to a reasonable time after the merchandise arrives at its destination in which to inspect it at that point, and to reject it if it does not comply with the contract."

*Subsections (2) to (4)*: There are apparently no direct parallels in prior North Carolina law, either by statutes or decision, to subsections (2), (3) and (4).

**§ 25-2-514. When documents deliverable on acceptance; when on payment.**—Unless otherwise agreed documents against which a draft is drawn are to be delivered to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 41, Uniform Bills of Lading Act.

**Changes:** Rewritten.

**Purposes of changes:** To make the provision one of general application so that:

1. It covers any document against which a draft may be drawn, whatever may be the form of the document, and applies to

interpret the action of a seller or consignor insofar as it may affect the rights and duties of any buyer, consignee or financing agency concerned with the paper. Supplementary or corresponding provisions are found in Sections 4—503 and 5—112.

2. An "arrival" draft is a sight draft within the purpose of this section.

**Cross references:**

Point 1: See Sections 2—502, 2—505(2), 2—507(2), 2—512, 2—513, 2—607 concerning protection of rights of buyer and seller, and 4—503 and 5—112 on delivery of documents.

**Definitional cross references:**

"Delivery". Section 1—201.  
 "Draft". Section 3—104.

**NORTH CAROLINA COMMENT**

North Carolina had no statute or case law corresponding to this section. Although North Carolina adopted the Uniform Bills of Lading Act in 1919, § 41 of the act was omitted. Its terms are set out below:

"§41. Demand, presentation or sight draft must be paid, but draft on more than three days time merely accepted before buyer is entitled to the accompanying bill.—Where the seller of goods draws on the buyer for the price of the goods and transmits the draft and a bill of lading for the goods whether directly to the buyer or through a bank or other agency, unless a different intention on the part of the seller appears, the buyer and all other parties interested shall be justified in assuming:

"(a) If the draft is by its terms or legal effect payable on demand or presentation or at sight, or not more than three days thereafter (whether such three days be termed days of grace or not), that the seller intended to require payment of the draft before the buyer should be entitled to receive or retain the bill.

"(b) If the draft is by its terms payable on time, extending beyond three days after demand, presentation or sight (whether such days be termed days of grace or not),

that the seller intended to require acceptance, but not payment of the draft before the buyer should be entitled to receive or retain the bill.

"The provisions of this section are applicable whether by the terms of the bill the goods are consigned to the seller, or to his order, or to the buyer, or to his order, or to a third person, or to his order."

The effect of this UCC modification of the Uniform Bills of Lading Act is to compel a document of title with draft attached to be delivered to the drawee upon his acceptance of the draft if by its terms it is payable more than three days after presentment; if it is payable within three days of presentment, the documents of title shall be delivered only upon payment being made.

In North Carolina where seller of goods shipped them by carrier, with a bill of lading sent with a draft attached for the purchase price, title remained in the seller until the draft was paid. Neither documents of title nor title passed until the draft was paid. See *Early & Daniels Co. v. Aulander Flour Mills*, 187 N.C. 344, 121 S.E. 539 (1924).

There is a change in North Carolina law by this addition.

**§ 25-2-515. Preserving evidence of goods in dispute.**—In furtherance of the adjustment of any claim or dispute

(a) either party on reasonable notification to the other and for the purpose of ascertaining the facts and preserving evidence has the right to inspect, test and sample the goods including such of them as may be in the possession or control of the other; and

(b) the parties may agree to a third party inspection or survey to determine the conformity or condition of the goods and may agree that the findings shall be binding upon them in any subsequent litigation or adjustment. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:**  
 None.

**Purposes:**

1. To meet certain serious problems which arise when there is a dispute as to the quality of the goods and thereby perhaps to aid the parties in reaching a settlement, and to further the use of devices which will promote certainty as to the condition of the goods, or at least aid in preserving evidence of their condition.

2. Under paragraph (a), to afford either

party an opportunity for preserving evidence, whether or not agreement has been reached, and thereby to reduce uncertainty in any litigation and, in turn perhaps, to promote agreement.

Paragraph (a) does not conflict with the provisions on the seller's right to resell rejected goods or the buyer's similar right. Apparent conflict between these provisions which will be suggested in certain circumstances is to be resolved by requiring prompt action by the parties. Nor

does paragraph (a) impair the effect of a term for payment before inspection. Short of such defects as amount to fraud or substantial failure of consideration, non-conformity is neither an excuse nor a defense to an action for non-acceptance of documents. Normally, therefore, until the buyer has made payment, inspected and rejected the goods, there is no occasion or use for the rights under paragraph (a).

3. Under paragraph (b), to provide for third party inspection upon the agreement of the parties, thereby opening the door to amicable adjustments based upon the findings of such third parties.

The use of the phrase "conformity or condition" makes it clear that the parties' agreement may range from a complete settlement of all aspects of the dispute by a third party to the use of a third party merely to determine and record the condition of the goods so that they can be resold or used to reduce the stake in controversy. "Conformity", at one end of the scale of possible issues, includes the whole question of interpretation of the agreement and its legal effect, the state of the goods in regard to quality and condition, whether any defects are due to factors which operate at the risk of the buyer, and the degree of non-conformity where that may be material. "Condition", at the other end of the scale, includes nothing but the degree of damage or deterioration

which the goods show. Paragraph (b) is intended to reach any point in the gamut which the parties may agree upon.

The principle of the section on reservation of rights reinforces this paragraph in simplifying such adjustments as the parties wish to make in partial settlement while reserving their rights as to any further points. Paragraph (b) also suggests the use of arbitration, where desired, of any points left open, but nothing in this section is intended to repeal or amend any statute governing arbitration. Where any question arises as to the extent of the parties' agreement under the paragraph, the presumption should be that it was meant to extend only to the relation between the contract description and the goods as delivered, since that is what a craftsman in the trade would normally be expected to report upon. Finally, a written and authenticated report of inspection or tests by a third party, whether or not sampling has been practicable, is entitled to be admitted as evidence under this Act, for it is a third party document.

#### Cross references:

Point 2: Sections 2—513(3), 2—706 and 2—711(2) and Article 5.

Point 3: Sections 1—202 and 1—207.

#### Definitional cross references:

"Conform". Section 2—106.

"Goods". Section 2—105.

"Notification". Section 1—201.

"Party". Section 1—201.

### NORTH CAROLINA COMMENT

There is no counterpart to this section in prior North Carolina law, either statutory or decisional.

## PART 6.

### BREACH, REPUDIATION AND EXCUSE.

§ 25-2-601. **Buyer's rights on improper delivery.**—Subject to the provisions of this article on breach in installment contracts (§ 25-2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (§§ 25-2-718 and 25-2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

(a) reject the whole; or

(b) accept the whole; or

(c) accept any commercial unit or units and reject the rest. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** No one general equivalent provision but numerous provisions, dealing with situations of non-conformity where buyer may accept or reject, including Sections 11, 44 and 69(1), Uniform Sales Act.

**Changes:** Partial acceptance in good faith is recognized and the buyer's reme-

dies on the contract for breach of warranty and the like, where the buyer has returned the goods after transfer of title, are no longer barred.

**Purposes of changes:** To make it clear that:

1. A buyer accepting a non-conforming tender is not penalized by the loss of any



remedy otherwise open to him. This policy extends to cover and regulate the acceptance of a part of any lot improperly tendered in any case where the price can reasonably be apportioned. Partial acceptance is permitted whether the part of the goods accepted conforms or not. The only limitation on partial acceptance is that good faith and commercial reasonableness must be used to avoid undue impairment of the value of the remaining portion of the goods. This is the reason for the insistence on the "commercial unit" in paragraph (c). In this respect, the test is not only what unit has been the basis of contract, but whether the partial acceptance produces so materially adverse an effect on the remainder as to constitute bad faith.

2. Acceptance made with the knowledge of the other party is final. An original refusal to accept may be withdrawn by a later acceptance if the seller has indicated that he is holding the tender open. However, if the buyer attempts to accept, either in whole or in part, after his original rejection has caused the seller to arrange for other disposition of the goods, the

buyer must answer for any ensuing damage since the next section provides that any exercise of ownership after rejection is wrongful as against the seller. Further, he is liable even though the seller may choose to treat his action as acceptance rather than conversion, since the damage flows from the misleading notice. Such arrangements for resale or other disposition of the goods by the seller must be viewed as within the normal contemplation of a buyer who has given notice of rejection. However, the buyer's attempts in good faith to dispose of defective goods where the seller has failed to give instructions within a reasonable time are not to be regarded as an acceptance.

#### Cross references:

Sections 2—602(2) (a), 2—612, 2—718 and 2—719.

#### Definitional cross references:

"Buyer". Section 2—103.

"Commercial unit". Section 2—105.

"Conform". Section 2—106.

"Contract". Section 1—201.

"Goods". Section 2—105.

"Installment contract". Section 2—612.

"Rights". Section 1—201.

### NORTH CAROLINA COMMENT

The law in North Carolina was that if the contract for the purchase of goods was *divisible*, a buyer's acceptance of a part of a shipment of goods did not obligate the buyer to receive the remainder of non-conforming goods which did not come up to the contract. See *Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co.*, 134 N.C. 574, 47 S.E. 116 (1904); *Freeman v. Skinner*, 31 N.C. 32 (1848). In other words, the prior North Carolina law recognized a buyer's right to accept part of a shipment of a divisible contract and reject the balance of shipment if it did not conform to the contract; such partial acceptance of goods did not constitute a waiver of defects as to the quality or quantity of the remainder of the goods.

*But see* *J. W. Sanders Cotton Mill v. Capps*, 104 F. Supp. 617 (E.D.N.C. 1952), that where there is a "single order and only one transaction" purchaser may not

accept part of a shipment and reject the remainder, but must either affirm or repudiate.

Thus under prior North Carolina law whether a buyer might accept part of the goods contracted for and reject nonconforming goods would appear to have been based on whether the contract was divisible. The UCC section here involved bases the buyer's right of acceptance or rejection on commercial units rather than upon the test of divisibility or indivisibility of the contract of sale. (A commercial unit is a unit of goods by commercial usage whose division impairs its character or value on the market or in use.)

The results of the cases under the prior law and under the UCC will probably be the same with reference to this section. The results should, however, be more predictable than under prior law.

**§ 25-2-602. Manner and effect of rightful rejection.**—(1) Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

(2) Subject to the provisions of the two following sections on rejected goods (§§ 25-2-603 and 25-2-604),

(a) after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller; and

(b) if the buyer has before rejection taken physical possession of goods in which

he does not have a security interest under the provisions of this article (subsection (3) of § 25-2-711), he is under a duty after rejection to hold them with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them; but

(c) the buyer has no further obligations with regard to goods rightfully rejected.

(3) The seller's rights with respect to goods wrongfully rejected are governed by the provisions of this article on seller's remedies in general (§ 25-2-703). (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 50, Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To make it clear that:

1. A tender or delivery of goods made pursuant to a contract of sale, even though wholly non-conforming, requires affirmative action by the buyer to avoid acceptance. Under subsection (1), therefore, the buyer is given a reasonable time to notify the seller of his rejection, but without such seasonable notification his rejection is ineffective. The sections of this Article dealing with inspection of goods must be read in connection with the buyer's reasonable time for action under this subsection. Contract provisions limiting the time for rejection fall within the rule of the section on "Time" and are effective if the time set gives the buyer a reasonable time for discovery of defects. What constitutes a due "notifying" of rejection by the buyer to the seller is defined in Section 1—201. be appropriately limited or modified when a negotiation is in process.

#### Cross references:

Point 1: Sections 1—201, 1—204(1) and (3), 2—512(2), 2—513(1) and 2—606(1)(b).

Point 2: Section 2—603(1).

Point 3: Section 2—703.

#### Definitional cross references:

"Buyer". Section 2—103.

2. Subsection (2) lays down the normal duties of the buyer upon rejection, which flow from the relationship of the parties. Beyond his duty to hold the goods with reasonable care for the buyer's disposition, this section continues the policy of prior uniform legislation in generally relieving the buyer from any duties with respect to them, except when the circumstances impose the limited obligation of salvage upon him under the next section.

3. The present section applies only to rightful rejection by the buyer. If the seller has made a tender which in all respects conforms to the contract, the buyer has a positive duty to accept and his failure to do so constitutes a "wrongful rejection" which gives the seller immediate remedies for breach. Subsection (3) is included here to emphasize the sharp distinction between the rejection of an improper tender and the non-acceptance which is a breach by the buyer.

4. The provisions of this section are to "Commercial unit". Section 2—105.

"Goods". Section 2—105.

"Merchant". Section 2—104.

"Notifies". Section 1—201.

"Reasonable time". Section 1—204.

"Remedy". Section 1—201.

"Rights". Section 1—201.

"Seasonably". Section 1—204.

"Security interest". Section 1—201.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

*Subsection (1)* accords with the cases of *Hajoca Corp. v. Brooks*, 249 N.C. 10, 105 S.E.2d 123 (1958); *Hendrix v. B & L Motors, Inc.*, 241 N.C. 644, 86 S.E.2d 448 (1955); *Hutchins v. Davis*, 230 N.C. 67, 52 S.E.2d 210 (1949); *May v. Loomis*, 140 N.C. 350, 52 S.E. 728 (1905); *Huyett & Smith Mfg. Co. v. Gray*, 124 N.C. 322, 32 S.E. 718 (1899); *Waldo v. Halsey*, 48 N.C. 107 (1855) and *McEntyre, v. McEntyre*, 34 N.C. 302 (1851). The latter case states: "If one, not having seen them, orders goods of a certain description, at a certain price, and the goods sent do not answer the description, he may

return them, within a reasonable time, and rescind the contract. . ."

*Subsection (2)* also accords with prior North Carolina law. *Huyett & Smith Mfg. Co. v. Gray*, 124 N.C. 322, 32 S.E. 718 (1899) states: "The purchaser is not compelled in all cases to reject the property, at once, upon its receipt; if it is machinery, he has a reasonable time to operate the machinery for the purpose of testing it. But when this is done, and it is found that the machine or the machinery does not fill the specifications of the contract and warranty, he must then abandon the contract and refuse to accept and use the property;

and if he does not do this, but continues the possession and use of the property, he will be deemed in law to have accepted the property, and his relief then will be an action for damages upon the breach of the

warranty." See *Nationwide Mut. Ins. Co. v. Don Allen Chevrolet Co.*, 253 N.C. 243, 116 S.E.2d 780 (1960); *Bruton v. Bland*, 260 N.C. 429, 132 S.E.2d 910 (1963).

**§ 25-2-603. Merchant buyer's duties as to rightfully rejected goods.**—(1) Subject to any security interest in the buyer (subsection (3) of § 25-2-711), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make reasonable efforts to sell them for the seller's account if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) When the buyer sells goods under subsection (1), he is entitled to reimbursement from the seller or out of the proceeds for reasonable expenses of caring for and selling them, and if the expenses include no selling commission then to such commission as is usual in the trade or if there is none to a reasonable sum not exceeding ten per cent (10%) on the gross proceeds.

(3) In complying with this section the buyer is held only to good faith and good faith conduct hereunder is neither acceptance nor conversion nor the basis of an action for damages. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:**  
None.

**Purposes:**

1. This section recognizes the duty imposed upon the merchant buyer by good faith and commercial practice to follow any reasonable instructions of the seller as to reshipping, storing, delivery to a third party, reselling or the like. Subsection (1) goes further and extends the duty to include the making of reasonable efforts to effect a salvage sale where the value of the goods is threatened and the seller's instructions do not arrive in time to prevent serious loss.

2. The limitations on the buyer's duty to resell under subsection (1) are to be liberally construed. The buyer's duty to resell under this section arises from commercial necessity and thus is present only when the seller has "no agent or place of business at the market of rejection". A financing agency which is acting in behalf of the seller in handling the documents rejected by the buyer is sufficiently the seller's agent to lift the burden of salvage resale from the buyer. (See provisions of Sections 4—503 and 5—112 on bank's duties with respect to rejected documents.) The buyer's duty to resell is extended only to goods in his "possession or control", but these are intended as words of wide, rather than narrow, import. In effect, the measure of the buyer's "control" is whether he can practically effect control without undue commercial burden.

3. The explicit provisions for reimbursement and compensation to the buyer in subsection (2) are applicable and necessary only where he is not acting under instructions from the seller. As provided in subsection (1) the seller's instructions to be "reasonable" must on demand of the buyer include indemnity for expenses.

4. Since this section makes the resale of perishable goods an affirmative duty in contrast to a mere right to sell as under the case law, subsection (3) makes it clear that the buyer is liable only for the exercise of good faith in determining whether the value of the goods is sufficiently threatened to justify a quick resale or whether he has waited a sufficient length of time for instructions, or what a reasonable means and place of resale is.

5. A buyer who fails to make a salvage sale when his duty to do so under this section has arisen is subject to damages pursuant to the section on liberal administration of remedies.

**Cross references:**

Point 2: Sections 4—503 and 5—112.  
Point 5: Section 1—106. Compare generally Section 2—706.

**Definitional cross references:**

"Buyer". Section 2—103.  
"Good faith". Section 1—201.  
"Goods". Section 2—105.  
"Merchant". Section 2—104.  
"Security interest". Section 1—201.  
"Seller". Section 2—103.



## NORTH CAROLINA COMMENT

There are no prior North Carolina statutes or cases which bear on the subject matter of this section.

**§ 25-2-604. Buyer's options as to salvage of rightfully rejected goods.**—Subject to the provisions of the immediately preceding section [§ 25-2-603] on perishables if the seller gives no instructions within a reasonable time after notification of rejection the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in the preceding section. Such action is not acceptance or conversion. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:**  
None.

**Purposes:**

The basic purpose of this section is two-fold: on the one hand it aims at reducing the stake in dispute and on the other at avoiding the pinning of a technical "acceptance" on a buyer who has taken steps towards realization on or preservation of the goods in good faith. This section is essentially a salvage section and the buyer's right to act under it is conditioned upon (1) non-conformity of the goods, (2) due notification of rejection to the seller under the section on manner of rejection, and (3) the absence of any instructions from the seller which the merchant-buyer has a duty to follow under the preceding section.

This section is designed to accord all

reasonable leeway to a rightfully rejecting buyer acting in good faith. The listing of what the buyer may do in the absence of instructions from the seller is intended to be not exhaustive but merely illustrative. This is not a "merchant's" section and the options are pure options given to merchant and nonmerchant buyers alike. The merchant-buyer, however, may in some instances be under a duty rather than an option to resell under the provisions of the preceding section.

**Cross references:**

Sections 2—602(1), 2—603(1) and 2—706.

**Definitional cross references:**

"Buyer" Section 2—103.

"Notification". Section 1—201.

"Reasonable time". Section 1—204.

"Seller". Section 2—103.

## NORTH CAROLINA COMMENT

There are no prior North Carolina statutes or decisions relating to this section.

**§ 25-2-605. Waiver of buyer's objections by failure to particularize.**—(1) The buyer's failure to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach

(a) where the seller could have cured it if stated seasonably; or

(b) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

(2) Payment against documents made without reservation of rights precludes recovery of the payment for defects apparent on the face of the documents. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:**  
None.

**Purposes:**

1. The present section rests upon a policy of permitting the buyer to give a quick and informal notice of defects in a tender without penalizing him for omissions in his statement, while at the same time

protecting a seller who is reasonably misled by the buyer's failure to state curable defects.

2. Where the defect in a tender is one which could have been cured by the seller, a buyer who merely rejects the delivery without stating his objections to it is probably acting in commercial bad faith

and seeking to get out of a deal which has become unprofitable. Subsection (1) (a), following the general policy of this Article which looks to preserving the deal wherever possible, therefore insists that the seller's right to correct his tender in such circumstances be protected.

3. When the time for cure is past, subsection (1) (b) makes it plain that a seller is entitled upon request to a final statement of objections upon which he can rely. What is needed is that he make clear to the buyer exactly what is being sought. A formal demand under paragraph (b) will be sufficient in the case of a merchant-buyer.

4. Subsection (2) applies to the particular case of documents the same principle which the section on effects of acceptance applies to the case of goods. The matter is dealt with in this section in terms of "waiver" of objections rather than of right to revoke acceptance, partly to avoid any confusion with the problems of acceptance of goods and partly because defects in documents which are not taken as grounds for rejection are generally minor ones. The only defects concerned in the present subsection are defects in the documents which are apparent on their face. Where

payment is required against the documents they must be inspected before payment, and the payment then constitutes acceptance of the documents. Under the section dealing with this problem, such acceptance of the documents does not constitute an acceptance of the goods or impair any options or remedies of the buyer for their improper delivery. Where the documents are delivered without requiring such contemporary action as payment from the buyer, the reason of the next section on what constitutes acceptance of goods, applies. Their acceptance by non-objection is therefore postponed until after a reasonable time for their inspection. In either situation, however, the buyer "waives" only what is apparent on the face of the documents.

#### Cross references:

Point 2: Section 2—508.

Point 4: Sections 2—512(2), 2—606(1) (b) and 2—607(2).

#### Definitional cross references:

"Between merchants" Section 2—104.

"Buyer". Section 2—103.

"Seasonably". Section 1—204.

"Seller". Section 2—103.

"Writing" and "written". Section 1—201.

### NORTH CAROLINA COMMENT

There are no prior North Carolina statutes or decisions relating to this section.

§ 25-2-606. What constitutes acceptance of goods.—(1) Acceptance of goods occurs when the buyer

(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or

(b) fails to make an effective rejection (subsection (1) of § 25-2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or

(c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

Prior uniform statutory provision. Section 48, Uniform Sales Act.

Changes: Rewritten, the qualification in paragraph (c) and subsection (2) being new; otherwise the general policy of the prior legislation is continued.

Purposes of change and new matter: To make it clear that:

1. Under this Article "acceptance" as applied to goods means that the buyer, pursuant to the contract, takes particular goods which have been appropriated to the contract as his own, whether or not he

is obligated to do so, and whether he does so by words, action, or silence when it is time to speak. If the goods conform to the contract, acceptance amounts only to the performance by the buyer of one part of his legal obligation.

2. Under this Article acceptance of goods is always acceptance of identified goods which have been appropriated to the contract or are appropriated by the contract. There is no provision for "acceptance of title" apart from acceptance in general, since acceptance of title is not material

under this Article to the detailed rights and duties of the parties. (See Section 2—401). The refinements of the older law between acceptance of goods and of title become unnecessary in view of the provisions of the sections on effect and revocation of acceptance, on effects of identification and on risk of loss, and those sections which free the seller's and buyer's remedies from the complications and confusions caused by the question of whether title has or has not passed to the buyer before breach.

3. Under paragraph (a), payment made after tender is always one circumstance tending to signify acceptance of the goods but in itself it can never be more than one circumstance and is not conclusive. Also, a conditional communication of acceptance always remains subject to its expressed conditions.

4. Under paragraph (c), any action taken by the buyer, which is inconsistent with his claim that he has rejected the goods, constitutes an acceptance. However, the provisions of paragraph (c) are subject to the sections dealing with rejection by the buyer which permit the buyer to take certain actions with respect to the goods pursuant to his options and duties imposed by those sections, without effecting an acceptance of the goods. The second clause of paragraph (c) modifies some of the prior case law and makes it clear that "acceptance" in law based on the wrongful act of the acceptor is acceptance only as

against the wrongdoer and then only at the option of the party wronged.

In the same manner in which a buyer can bind himself, despite his insistence that he is rejecting or has rejected the goods, by an act inconsistent with the seller's ownership under paragraph (c), he can obligate himself by a communication of acceptance despite a prior rejection under paragraph (a). However, the sections on buyer's rights on improper delivery and on the effect of rightful rejection, make it clear that after he once rejects a tender, paragraph (a) does not operate in favor of the buyer unless the seller has re-tendered the goods or has taken affirmative action indicating that he is holding the tender open. See also Comment 2 to Section 2—601.

5. Subsection (2) supplements the policy of the section on buyer's rights on improper delivery, recognizing the validity of a partial acceptance but insisting that the buyer exercise this right only as to whole commercial units.

#### Cross references:

Point 2: Sections 2—401, 2—509, 2—510, 2—607, 2—608 and Part 7.

Point 4: Sections 2—601 through 2—604.

Point 5: Section 2—601.

#### Definitional cross references:

"Buyer". Section 2—103.

"Commercial unit". Section 2—105.

"Goods". Section 2—105.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

*Subsections (1) (a) and (b)* are in accord with *Richardson v. Woodruff*, 178 N.C. 46, 100 S.E. 173 (1919), which holds that there is no acceptance of goods by the buyer until he has had an opportunity to inspect the goods. Continued use, however, after discovery of nonconformity, or after a reasonable opportunity to discover nonconformity, constitutes an acceptance. *Hajoca Corp. v. Brooks*, 249 N.C. 10, 105 S.E.2d 123 (1958).

*Subsection (1) (c)* accords with *Ritchie v. Ritchie*, 192 N.C. 538, 135 S.E. 458 (1926), which holds that if a buyer sells

part of the goods and keeps the proceeds of the sale and applies them to his own use, there is an acceptance. See *Hajoca Corp. v. Brooks*, 249 N.C. 10, 105 S.E.2d 123 (1958), which holds, however, that retention of goods for the purpose of testing it for a reasonable time or at the request of the seller in order that he may endeavor to remedy the defects does not constitute an acceptance or waiver of the buyer's right to rescind.

*Subsection (2)* has no statutory or decisional parallel in prior North Carolina law.

**§ 25-2-607. Effect of acceptance; notice of breach; burden of establishing breach after acceptance; notice of claim or litigation to person answerable over.**—(1) The buyer must pay at the contract rate for any goods accepted.

(2) Acceptance of goods by the buyer precludes rejection of the goods accepted and if made with knowledge of a nonconformity cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured but acceptance does not of itself impair any other remedy provided by this article for nonconformity.



(3) Where a tender has been accepted

(a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and

(b) if the claim is one for infringement or the like (subsection (3) of § 25-2-312) and the buyer is sued as a result of such a breach he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

(4) The burden is on the buyer to establish any breach with respect to the goods accepted.

(5) Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over

(a) he may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigations, then unless the seller after seasonable receipt of the notice does come in and defend he is so bound.

(b) if the claim is one for infringement or the like (subsection (3) of § 25-2-312) the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then unless the buyer after seasonable receipt of the demand does turn over control the buyer is so barred.

(6) The provisions of subsections (3), (4) and (5) apply to any obligation of a buyer to hold the seller harmless against infringement or the like (subsection (3) of § 25-2-312). (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Subsection (1)—Section 41, Uniform Sales Act; Subsections (2) and (3)—Sections 49 and 69, Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To continue the prior basic policies with respect to acceptance of goods while making a number of minor though material changes in the interest of simplicity and commercial convenience so that:

1. Under subsection (1), once the buyer accepts a tender the seller acquires a right to its price on the contract terms. In cases of partial acceptance, the price of any part accepted is, if possible, to be reasonably apportioned, using the type of apportionment familiar to the courts in quantum valebat cases, to be determined in terms of "the contract rate," which is the rate determined from the bargain in fact (the agreement) after the rules and policies of this Article have been brought to bear.

2. Under subsection (2) acceptance of goods precludes their subsequent rejection. Any return of the goods thereafter must be by way of revocation of acceptance under the next section. Revocation is unavailable for a non-conformity known to the buyer at the time of acceptance, except where the buyer has accepted on the

reasonable assumption that the non-conformity would be seasonably cured.

3. All other remedies of the buyer remain unimpaired under subsection (2). This is intended to include the buyer's full rights with respect to future installments despite his acceptance of any earlier non-conforming installment.

4. The time of notification is to be determined by applying commercial standards to a merchant buyer. "A reasonable time" for notification from a retail consumer is to be judged by different standards so that in his case it will be extended, for the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy.

The content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched. There is no reason to require that the notification which saves the buyer's rights under this section must include a clear statement of all the objections that will be relied on by the buyer, as under the section covering statements of defects upon rejection (Section 2-605). Nor is there reason for requiring the notification to be a claim for damages or of any threatened litigation or other resort

to a remedy. The notification which saves the buyer's rights under this Article need only be such as informs the seller that the transaction is claimed to involve a breach, and thus opens the way for normal settlement through negotiation.

5. Under this Article various beneficiaries are given rights for injuries sustained by them because of the seller's breach of warranty. Such a beneficiary does not fall within the reason of the present section in regard to discovery of defects and the giving of notice within a reasonable time after acceptance, since he has nothing to do with acceptance. However, the reason of this section does extend to requiring the beneficiary to notify the seller that an injury has occurred. What is said above, with regard to the extended time for reasonable notification from the lay consumer after the injury is also applicable here; but even a beneficiary can be properly held to the use of good faith in notifying, once he has had time to become aware of the legal situation.

6. Subsection (4) unambiguously places the burden of proof to establish breach on the buyer after acceptance. However, this rule becomes one purely of procedure when the tender accepted was non-conforming and the buyer has given the seller notice of breach under subsection (3). For subsection (2) makes it clear that acceptance leaves unimpaired the buyer's right to be made whole, and that right can be exercised by the buyer not only by

way of cross-claim for damages, but also by way of recoupment in diminution or extinction of the price.

7. Subsections (3) (b) and (5) (b) give a warrantor against infringement an opportunity to defend or compromise third-party claims or be relieved of his liability. Subsection (5) (a) codifies for all warranties the practice of voucher to defend. Compare Section 3—803. Subsection (6) makes these provisions applicable to the buyer's liability for infringement under Section 2—312.

8. All of the provisions of the present section are subject to any explicit reservation of rights.

#### Cross references:

Point 1: Section 1—201.

Point 2: Section 2—608.

Point 4: Sections 1—204 and 2—605.

Point 5: Section 2—318.

Point 6: Section 2—717.

Point 7: Sections 2—312 and 3—803.

Point 8: Section 1—207.

#### Definitional cross references:

"Burden of establishing". Section 1—201.

"Buyer". Section 2—103.

"Conform". Section 2—106.

"Contract". Section 1—201.

"Goods". Section 2—105.

"Notifies". Section 1—201.

"Reasonable time". Section 1—204.

"Remedy". Section 1—201.

"Seasonably". Section 1—204.

### NORTH CAROLINA COMMENT

*Subsection (1)* accords with *Parker v. Fenwick*, 138 N.C. 209, 50 S.E. 627 (1905), which requires payment of price upon acceptance. See also *Dodson v. Moore*, 64 N.C. 512 (1870).

*Subsection (2)* accords with *Spiers v. Halsted*, 74 N.C. 620 (1876), that mere acceptance of a purchased article does not itself constitute a waiver of damages for a delay in performance of the contract. *Cox v. Long*, 69 N.C. 7 (1873), *Thomas v. Simpson*, 80 N.C. 4 (1899), and *Potter v. National Supply Co.*, 230 N.C. 1, 51 S.E.2d 908 (1949), hold that a purchaser does not waive his right to sue a seller for damages because of the inferior quality of articles purchased or for breach of warranty by

the mere acceptance and retention of goods not fulfilling the terms of the contract.

*Subsection (3) (a)* accords with *Main v. Field*, 144 N.C. 307, 56 S.E. 943 (1907), that a buyer of goods has a reasonable time within which to give the seller notice of a breach of warranty after acceptance of the goods.

*Subsection (3) (b)* has no prior North Carolina statutory or decisional parallel.

*Subsection (4)* accords with *Furst v. Taylor*, 204 N.C. 603, 169 S.E. 185 (1933); *Parker v. Fenwick*, 138 N.C. 209, 50 S.E. 627 (1905).

*Subsections (5) and (6)* have no prior North Carolina statutory or decisional equivalents.

§ 25-2-608. **Revocation of acceptance in whole or in part.**—(1) The buyer may revoke his acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) without discovery of such nonconformity if his acceptance was reasonably

induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 69(1) (d), (3), (4) and (5), Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To make it clear that:

1. Although the prior basic policy is continued, the buyer is no longer required to elect between revocation of acceptance and recovery of damages for breach. Both are now available to him. The non-alternative character of the two remedies is stressed by the terms used in the present section. The section no longer speaks of "rescission," a term capable of ambiguous application either to transfer of title to the goods or to the contract of sale and susceptible also of confusion with cancellation for cause of an executed or executory portion of the contract. The remedy under this section is instead referred to simply as "revocation of acceptance" of goods tendered under a contract for sale and involves no suggestion of "election" of any sort.

2. Revocation of acceptance is possible only where the non-conformity substantially impairs the value of the goods to the buyer. For this purpose the test is not what the seller had reason to know at the time of contracting; the question is whether the non-conformity is such as will in fact cause a substantial impairment of value to the buyer though the seller had no advance knowledge as to the buyer's particular circumstances.

3. "Assurances" by the seller under paragraph (b) of subsection (1) can rest as well in the circumstances or in the contract as in explicit language used at the time of delivery. The reason for recognizing such assurances is that they induce the buyer to delay discovery. These are the only assurances involved in paragraph (b). Explicit assurances may be made either in good faith or bad faith. In either case any remedy accorded by this Article is available to the buyer under the section on remedies for fraud.

4. Subsection (2) requires notification of revocation of acceptance within a reason-

able time after discovery of the grounds for such revocation. Since this remedy will be generally resorted to only after attempts at adjustment have failed, the reasonable time period should extend in most cases beyond the time in which notification of breach must be given, beyond the time for discovery of non-conformity after acceptance and beyond the time for rejection after tender. The parties may by their agreement limit the time for notification under this section, but the same sanctions and considerations apply to such agreements as are discussed in the comment on manner and effect of rightful rejection.

5. The content of the notice under subsection (2) is to be determined in this case as in others by considerations of good faith, prevention of surprise, and reasonable adjustment. More will generally be necessary than the mere notification of breach required under the preceding section. On the other hand the requirements of the section on waiver of buyer's objections do not apply here. The fact that quick notification of trouble is desirable affords good ground for being slow to bind a buyer by his first statement. Following the general policy of this Article, the requirements of the content of notification are less stringent in the case of a non-merchant buyer.

6. Under subsection (2) the prior policy is continued of seeking substantial justice in regard to the condition of goods restored to the seller. Thus the buyer may not revoke his acceptance if the goods have materially deteriorated except by reason of their own defects. Worthless goods, however, need not be offered back and minor defects in the articles reoffered are to be disregarded.

7. The policy of the section allowing partial acceptance is carried over into the present section and the buyer may revoke his acceptance, in appropriate cases, as to the entire lot or any commercial unit thereof.

**Cross references:**

Point 3: Section 2—721.



Point 4: Sections 1—204, 2—602 and 2—607.

Point 5: Sections 2—605 and 2—607.

Point 7: Section 2—601.

Definitional cross references:

"Buyer". Section 2—103.

"Commercial unit". Section 2—105.

"Conform". Section 2—106.

"Goods". Section 2—105.

"Lot". Section 2—105.

"Notifies". Section 1—201.

"Reasonable time". Section 1—204.

"Rights". Section 1—201.

"Seasonably". Section 1—204.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

*Subsection (1) (a)* accords with *Hajoca Corp. v. Brooks*, 249 N.C. 10, 105 S.E.2d 123 (1958), that a buyer's retention of goods during a period in which seller makes efforts to remedy defects does not bar buyer from thereafter electing to rescind contract.

*Subsection (1) (b)* accords with *Case Threshing Mach. Co. v. McKay*, 161 N.C. 584, 77 S.E. 848 (1913), that retention of a machine at seller's request to try to make it perform the service it was represented as capable of performing does not prevent the purchaser from rescinding the purchase. See also *Thomas v. Simpson*, 80 N.C. 4 (1879), that acceptance of goods in ignorance of defect therein is not a waiver of implied warranty of quality.

*Subsection (2)* accords with *Huyett & Smith Mfg. Co. v. Gray*, 124 N.C. 322, 32 S.E. 718 (1899), that a purchaser has reasonable time to operate machinery for the purpose of testing it; if machinery does not come up to contract, he may abandon the contract and refuse to receive and use the property. See also *Hendrix v. B & L Motors, Inc.*, 241 N. C. 644, 86 S.E.2d 448 (1955).

*Subsection (3)* accords with *Hendrix v. B & L Motors, Inc.*, 241 N.C. 644, 86 S.E.2d 448 (1955), and *Curtis v. White Cadillac-Olds, Inc.*, 248 N.C. 717, 104 S.E.2d 877 (1958).

§ 25-2-609. Right to adequate assurance of performance.—(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** See Sections 53, 54(1) (b), 55 and 63(2), Uniform Sales Act.

**Purposes:**

1. The section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit and that a continuing sense of reliance and security that the promised performance will be forthcoming when due, is an important feature of the bargain. If either the willingness or the ability of a party to perform

declines materially between the time of contracting and the time for performance, the other party is threatened with the loss of a substantial part of what he has bargained for. A seller needs protection not merely against having to deliver on credit to a shaky buyer, but also against having to procure and manufacture the goods, perhaps turning down other customers. Once he has been given reason to believe that the buyer's performance has become uncertain, it is an undue hardship to force him to continue his own performance. Similarly, a buyer who believes that the seller's deliveries have become uncertain

cannot safely wait for the due date of performance when he has been buying to assure himself of materials for his current manufacturing or to replenish his stock of merchandise.

2. Three measures have been adopted to meet the needs of commercial men in such situations. First, the aggrieved party is permitted to suspend his own performance and any preparation therefor, with excuse for any resulting necessary delay, until the situation has been clarified. "Suspend performance" under this section means to hold up performance pending the outcome of the demand, and includes also the holding up of any preparatory action. This is the same principle which governs the ancient law of stoppage and seller's lien, and also of excuse of a buyer from prepayment if the seller's actions manifest that he cannot or will not perform. (Original Act, Section 63 (2).)

Secondly, the aggrieved party is given the right to require adequate assurance that the other party's performance will be duly forthcoming. This principle is reflected in the familiar clauses permitting the seller to curtail deliveries if the buyer's credit becomes impaired, which when held within the limits of reasonableness and good faith actually express no more than the fair business meaning of any commercial contract.

Third, and finally, this section provides the means by which the aggrieved party may treat the contract as broken if his reasonable grounds for insecurity are not cleared up within a reasonable time. This is the principle underlying the law of anticipatory breach, whether by way of defective part performance or by repudiation. The present section merges these three principles of law and commercial practice into a single theory of general application to all sales agreements looking to future performance.

3. Subsection (2) of the present section requires that "reasonable" grounds and "adequate" assurance as used in subsection (1) be defined by commercial rather than legal standards. The express reference to commercial standards carries no connotation that the obligation of good faith is not equally applicable here.

Under commercial standards and in accord with commercial practice, a ground for insecurity need not arise from or be directly related to the contract in question. The law as to "dependence" or "independence" of promises within a single contract does not control the application of the present section.

Thus a buyer who falls behind in "his account" with the seller, even though the items involved have to do with separate and legally distinct contracts, impairs the seller's expectation of due performance. Again, under the same test, a buyer who requires precision parts which he intends to use immediately upon delivery, may have reasonable grounds for insecurity if he discovers that his seller is making defective deliveries of such parts to other buyers with similar needs. Thus, too, in a situation such as arose in *Jay Dreher Corporation v. Delco Appliance Corporation*, 93 F. 2d 275 (C.C.A.2, 1937), where a manufacturer gave a dealer an exclusive franchise for the sale of his product but on two or three occasions breached the exclusive dealing clause, although there was no default in orders, deliveries or payments under the separate sales contract between the parties, the aggrieved dealer would be entitled to suspend his performance of the contract for sale under the present section and to demand assurance that the exclusive dealing contract would be lived up to. There is no need for an explicit clause tying the exclusive franchise into the contract for the sale of goods since the situation itself ties the agreements together.

The nature of the sales contract enters also into the question of reasonableness. For example, a report from an apparently trustworthy source that the seller had shipped defective goods or was planning to ship them would normally give the buyer reasonable grounds for insecurity. But when the buyer has assumed the risk of payment before inspection of the goods, as in a sales contract on C.I.F. or similar cash against documents terms, that risk is not to be evaded by a demand for assurance. Therefore no ground for insecurity would exist under this section unless the report went to a ground which would excuse payment by the buyer.

4. What constitutes "adequate" assurance of due performance is subject to the same test of factual conditions. For example, where the buyer can make use of a defective delivery, a mere promise by a seller of good repute that he is giving the matter his attention and that the defect will not be repeated, is normally sufficient. Under the same circumstances, however, a similar statement by a known corner-cutter might well be considered insufficient without the posting of a guaranty or, if so demanded by the buyer, a speedy replacement of the delivery involved. By the same token where a delivery has de-

fects, even though easily curable, which interfere with easy use by the buyer, no verbal assurance can be deemed adequate which is not accompanied by replacement, repair, money-allowance, or other commercially reasonable cure.

A fact situation such as arose in *Corn Products Refining Co. v. Fasola*, 94 N.J.L. 181, 109 A. 505 (1920) offers illustration both of reasonable grounds for insecurity and "adequate" assurance. In that case a contract for the sale of oils on 30 days' credit, 2% off for payment within 10 days, provided that credit was to be extended to the buyer only if his financial responsibility was satisfactory to the seller. The buyer had been in the habit of taking advantage of the discount but at the same time that he failed to make his customary 10 day payment, the seller heard rumors, in fact false, that the buyer's financial condition was shaky. Thereupon, the seller demanded cash before shipment or security satisfactory to him. The buyer sent a good credit report from his banker, expressed willingness to make payments when due on the 30 day terms and insisted on further deliveries under the contract. Under this Article the rumors, although false, were enough to make the buyer's financial condition "unsatisfactory" to the seller under the contract clause. Moreover, the buyer's practice of taking the cash discounts is enough, apart from the contract clause, to lay a commercial foundation for suspicion when the practice is suddenly stopped. These matters, however, go only to the justification of the seller's demand for security, or his "reasonable grounds for insecurity".

The adequacy of the assurance given is not measured as in the type of "satisfaction" situation affected with intangibles, such as in personal service cases, cases involving a third party's judgment as final, or cases in which the whole contract is dependent on one party's satisfaction, as in a sale on approval. Here, the seller must exercise good faith and observe commercial standards. This Article thus approves the statement of the court in *James B. Berry's Sons Co. of Illinois v. Monark Gasoline & Oil Co., Inc.*, 32 F. 2d 74, (C.C.A.8, 1929), that the seller's satisfaction under such a clause must be based upon reason and must not be arbitrary or capricious; and rejects the purely personal "good faith" test of the *Corn Products Refining Co.* case, which held that in the seller's sole judgment, if for any reason he was dissatisfied, he was entitled to revoke the credit. In the absence of the

buyer's failure to take the 2% discount as was his custom, the banker's report given in that case would have been "adequate" assurance under this Act, regardless of the language of the "satisfaction" clause. However, the seller is reasonably entitled to feel insecure at a sudden expansion of the buyer's use of a credit term, and should be entitled either to security or to a satisfactory explanation.

The entire foregoing discussion as to adequacy of assurance by way of explanation is subject to qualification when repeated occasions for the application of this section arise. This Act recognizes that repeated delinquencies must be viewed as cumulative. On the other hand, commercial sense also requires that if repeated claims for assurance are made under this section, the basis for these claims must be increasingly obvious.

5. A failure to provide adequate assurance of performance and thereby to reestablish the security of expectation, results in a breach only "by repudiation" under subsection (4). Therefore, the possibility is continued of retraction of the repudiation under the section dealing with that problem, unless the aggrieved party has acted on the breach in some manner.

The thirty day limit on the time to provide assurance is laid down to free the question of reasonable time from uncertainty in later litigation.

6. Clauses seeking to give the protected party exceedingly wide powers to cancel or readjust the contract when ground for insecurity arises must be read against the fact that good faith is a part of the obligation of the contract and not subject to modification by agreement and includes, in the case of a merchant, the reasonable observance of commercial standards of fair dealing in the trade. Such clauses can thus be effective to enlarge the protection given by the present section to a certain extent, to fix the reasonable time within which requested assurance must be given, or to define adequacy of the assurance in any commercially reasonable fashion. But any clause seeking to set up arbitrary standards for action is ineffective under this Article. Acceleration clauses are treated similarly in the Articles on Commercial Paper and Secured Transactions.

#### Cross references:

Point 3: Section 1—203.

Point 5: Section 2—611.

Point 6: Sections 1—203 and 1—208 and Articles 3 and 9.

#### Definitional cross references:

"Aggrieved party". Section 1—201.



"Between merchants". Section 2—104.

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Party". Section 1—201.

"Reasonable time". Section 1—204.

"Rights". Section 1—201.

"Writing". Section 1—201.

### NORTH CAROLINA COMMENT

There was no statutory or case law in North Carolina as to security for performance to be applicable in anticipation of

nonperformance, repudiation or insecurity on the part of either of the contracting parties. This is entirely new.

**§ 25-2-610. Anticipatory repudiation.**—When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

(a) for a commercially reasonable time await performance by the repudiating party; or

(b) resort to any remedy for breach (§ 25-2-703 or § 25-2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and

(c) in either case suspend his own performance or proceed in accordance with the provisions of this article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (§ 25-2-704). (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** See Sections 63(2) and 65, Uniform Sales Act.

**Purposes:** To make it clear that:

1. With the problem of insecurity taken care of by the preceding section and with provision being made in this Article as to the effect of a defective delivery under an installment contract, anticipatory repudiation centers upon an overt communication of intention or an action which renders performance impossible or demonstrates a clear determination not to continue with performance.

Under the present section when such a repudiation substantially impairs the value of the contract, the aggrieved party may at any time resort to his remedies for breach, or he may suspend his own performance while he negotiates with, or awaits performance by, the other party. But if he awaits performance beyond a commercially reasonable time he cannot recover resulting damages which he should have avoided.

2. It is not necessary for repudiation that performance be made literally and utterly impossible. Repudiation can result from action which reasonably indicates a rejection of the continuing obligation. And, a repudiation automatically results under the preceding section on insecurity when a party fails to provide adequate assurance of due future performance within thirty days after a justifiable demand therefor has been made. Under the language of this section, a demand by one or both parties for more than the contract calls for in the way of counter-performance is not in itself a repudiation nor does

it invalidate a plain expression of desire for future performance. However, when under a fair reading it amounts to a statement of intention not to perform except on conditions which go beyond the contract, it becomes a repudiation.

3. The test chosen to justify an aggrieved party's action under this section is the same as that in the section on breach in installment contracts—namely the substantial value of the contract. The most useful test of substantial value is to determine whether material inconvenience or injustice will result if the aggrieved party is forced to wait and receive an ultimate tender, minus the part or aspect repudiated.

4. After repudiation, the aggrieved party may immediately resort to any remedy he chooses provided he moves in good faith (see Section 1—203). Inaction and silence by the aggrieved party may leave the matter open but it cannot be regarded as misleading the repudiating party. Therefore the aggrieved party is left free to proceed at any time with his options under this section, unless he has taken some positive action which in good faith requires notification to the other party before the remedy is pursued.

#### Cross references:

Point 1: Sections 2—609 and 2—612.

Point 2: Section 2—609.

Point 3: Section 2—612.

Point 4: Section 1—203.

#### Definitional cross references:

"Aggrieved party". Section 1—201.

"Contract". Section 1—201.

"Party". Section 1—201.

"Remedy". Section 1—201.

## NORTH CAROLINA COMMENT

An anticipatory breach of contracts was apparently actionable in North Carolina before the date fixed by a contract for performance. If one party renounced the contract before the date fixed by contract for performance, the other party might treat the renunciation as a "breach" and sue for his damages at once provided the renunciation covered the entire performance to which the contract bound the promisor. See *Pappas v. Crist*, 223 N.C. 265, 25 S.E.2d 850 (1943); *Tillis v. Calvin Cotton Mills*, 251 N.C. 359, 111 S.E.2d 606 (1959). In North Carolina, however, for the breach of an executory contract the plaintiff might recover only such substantial damages as could be ascertained and measured with reasonable certainty. While absolute certainty was not required, evidence of damages had to be sufficiently specific and complete to permit the jury to arrive at a reasonable conclusion. A witness was not permitted to give a mere guess or opinion, unsupported by facts, as to the amount of damages arising upon a breach of contract. See *Tillis v. Calvin Cotton Mills*, 251 N.C. 359, 111 S.E.2d 606 (1959). In addition, the contractor against whom the contract was breached was normally under an obligation to exercise reasonable diligence to minimize the damages caused to him by the breach. *Tillis v. Calvin Cotton Mills*, 251 N.C. 359, 111 S.E.2d 606 (1959). The result was that in North Carolina, notwithstanding statements of the court that anticipatory breaches of contract were actionable, the court did not favor such actions. In most cases, due to the requirements of certainty and mitigation of damages by the party against whom the contract had been breached, for practical purposes, damages could not be adequately measured prior to the date when the contract by its terms should have been performed. Compare: *McJunkin Corp. v. North Carolina Natural Gas Corp.*, 300 F.2d 794 (4th Cir. 1961); *Tillis v. Calvin Cotton Mills*, 251 N.C. 359, 111 S.E.2d 606 (1959).

The UCC, GS 25-2-610, provides for immediate relief for an aggrieved party upon a repudiation of the contract by the other party by an overt communication of intention or action which renders performance of the contract impossible or demonstrates clearly an intention not to continue with the performance. It gives

the aggrieved party (a) the right to wait a commercially reasonable time for performance by the repudiating party; (b) the right to resort to any remedy set out in GS 25-2-703 (if the seller) and GS 25-2-711 (if the buyer) for breach; or (c) the right to suspend his own performance. (Subsection (c) accords with prior North Carolina law on this point. See *Wade v. Lutterloh*, 196 N.C. 116, 144 S.E. 694 (1928), that renunciation by one party to contract excuses other from any further offer to perform.)

While North Carolina recognized the doctrine of anticipatory breach of contracts, the limits of the doctrine, especially as to damages recoverable, were uncertain. The UCC not only gives either aggrieved party the right to sue as for breach or to suspend performance in case of repudiation of a contract, but it also establishes the date for the determination of damages. (The date of the anticipatory repudiation of the contract.)

Under the Restatement, Contracts § 338 (1932), and in most states recognizing the doctrine of anticipatory breach in connection with sales, the measure of damages recoverable was the difference between the price as specified in the contract and the market price at the date and place when delivery or performance was to have been made. This formula is complicated as it is often well nigh impossible to determine the price of goods at a future date, especially when the duty to mitigate damages is considered which might very well result in no damages at all.

This section of the UCC and GS 25-2-723 make damages less speculative, providing that if the action comes to trial by reason of anticipatory breach before the date of performance specified in the contract, the damages shall be the difference between the contract price specified and the market price as of "the time the aggrieved party learned of the repudiation." This apparently changes the law of North Carolina. See *McJunkin Corp. v. North Carolina Natural Gas Corp.*, 300 F.2d 794 (4th Cir. 1961), which held that damages for anticipatory breach of contract were to be assessed on the basis of profit factors existent at the time of performance fixed by contract, and not at the time of repudiation.

**§ 25-2-611. Retraction of anticipatory repudiation.**—(1) Until the repudiating party's next performance is due he can retract his repudiation unless

the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this article (§ 25-2-609).

(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** To make it clear that:

1. The repudiating party's right to reinstate the contract is entirely dependent upon the action taken by the aggrieved party. If the latter has cancelled the contract or materially changed his position at any time after the repudiation, there can be no retraction under this section.

2. Under subsection (2) an effective retraction must be accompanied by any assurances demanded under the section dealing with right to adequate assurance. A repudiation is of course sufficient to give reasonable ground for insecurity and to war-

rant a request for assurance as an essential condition of the retraction. However, after a timely and unambiguous expression of retraction, a reasonable time for the assurance to be worked out should be allowed by the aggrieved party before cancellation.

**Cross reference:**

Point 2: Section 2—609.

**Definitional cross references:**

"Aggrieved party". Section 1—201.

"Cancellation". Section 2—106.

"Contract". Section 1—201.

"Party". Section 1—201.

"Rights". Section 1—201.

#### NORTH CAROLINA COMMENT

There is no prior case or statutory law in connection with this section.

§ 25-2-612. "Installment contract"; breach.—(1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer may reject any installment which is nonconforming if the nonconformity substantially impairs the value of that installment and cannot be cured or if the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(3) Whenever nonconformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a nonconforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 45(2), Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To continue prior law but to make explicit the more mercantile interpretation of many of the rules involved, so that:

1. The definition of an installment contract is phrased more broadly in this Article so as to cover installment deliveries tacitly authorized by the circumstances or by the option of either party.

2. In regard to the apportionment of the price for separate payment this Article ap-

plies the more liberal test of what can be apportioned rather than the test of what is clearly apportioned by the agreement. This Article also recognizes approximate calculation or apportionment of price subject to subsequent adjustment. A provision for separate payment for each lot delivered ordinarily means that the price is at least roughly calculable by units of quantity, but such a provision is not essential to an "installment contract." If separate acceptance of separate deliveries is contemplated, no generalized contrast between wholly "entire" and wholly "divisi-



ble" contracts has any standing under this Article.

3. This Article rejects any approach which gives clauses such as "each delivery is a separate contract" their legalistically literal effect. Such contracts nonetheless call for installment deliveries. Even where a clause speaks of "a separate contract for all purposes", a commercial reading of the language under the section on good faith and commercial standards requires that the singleness of the document and the negotiation, together with the sense of the situation, prevail over any uncommercial and legalistic interpretation.

4. One of the requirements for rejection under subsection (2) is non-conformity substantially impairing the value of the installment in question. However, an installment agreement may require accurate conformity in quality as a condition to the right to acceptance if the need for such conformity is made clear either by express provision or by the circumstances. In such a case the effect of the agreement is to define explicitly what amounts to substantial impairment of value impossible to cure. A clause requiring accurate compliance as a condition to the right to acceptance must, however, have some basis in reason, must avoid imposing hardship by surprise and is subject to waiver or to displacement by practical construction.

Substantial impairment of the value of an installment can turn not only on the quality of the goods but also on such factors as time, quantity, assortment, and the like. It must be judged in terms of the normal or specifically known purposes of the contract. The defect in required documents refers to such matters as the absence of insurance documents under a C.I.F. contract, falsity of a bill of lading, or one failing to show shipment within the contract period or to the contract destination. Even in such cases, however, the provisions on cure of tender apply if appropriate documents are readily procurable.

5. Under subsection (2) an installment delivery must be accepted if the non-conformity is curable and the seller gives adequate assurance of cure. Cure of non-conformity of an installment in the first instance can usually be afforded by an allowance against the price, or in the case of reasonable discrepancies in quantity either by a further delivery or a partial rejection. This Article requires reasonable action by a buyer in regard to discrepant delivery and good faith requires that the buyer make any reasonable minor outlay of time or money necessary to cure an

overshipment by severing out an acceptable percentage thereof. The seller must take over a cure which involves any material burden; the buyer's obligation reaches only to cooperation. Adequate assurance for purposes of subsection (2) is measured by the same standards as under the section on right to adequate assurance of performance.

6. Subsection (3) is designed to further the continuance of the contract in the absence of an overt cancellation. The question arising when an action is brought as to a single installment only is resolved by making such action waive the right of cancellation. This involves merely a defect in one or more installments, as contrasted with the situation where there is a true repudiation within the section on anticipatory repudiation. Whether the non-conformity in any given installment justifies cancellation as to the future depends, not on whether such non-conformity indicates an intent or likelihood that the future deliveries will also be defective, but whether the non-conformity substantially impairs the value of the whole contract. If only the seller's security in regard to future installments is impaired, he has the right to demand adequate assurances of proper future performance but has not an immediate right to cancel the entire contract. It is clear under this Article, however, that defects in prior installments are cumulative in effect, so that acceptance does not wash out the defect "waived." Prior policy is continued, putting the rule as to buyer's default on the same footing as that in regard to seller's default.

7. Under the requirement of seasonable notification of cancellation under subsection (3), a buyer who accepts a non-conforming installment which substantially impairs the value of the entire contract should properly be permitted to withhold his decision as to whether or not to cancel pending a response from the seller as to his claim for cure or adjustment. Similarly, a seller may withhold a delivery pending payment for prior ones, at the same time delaying his decision as to cancellation. A reasonable time for notifying of cancellation, judged by commercial standards under the section on good faith, extends of course to include the time covered by any reasonable negotiation in good faith. However, during this period the defaulting party is entitled, on request, to know whether the contract is still in effect, before he can be required to perform further.

Cross references:

Point 2: Sections 2—307 and 2—607.

Point 3: Section 1—203.

Point 5: Sections 2—208 and 2—609.

Point 6: Section 2—610.

**Definitional cross references:**

“Action”. Section 1—201.

“Aggrieved party”. Section 1—201.

“Buyer”. Section 2—103.

“Cancellation”. Section 2—106.

“Conform”. Section 2—106.

“Contract”. Section 1—201.

“Lot”. Section 2—105.

“Notifies”. Section 1—201.

“Seasonably”. Section 1—204.

“Seller”. Section 2—103.

### NORTH CAROLINA COMMENT

In accord with *LaVallette v. Booth*, 131 N.C. 36, 42 S.E. 446 (1902), that buyer may reject installment which is nonconforming or may reject further performance if nonconformity *substantially* impairs whole contract. But compare *Statesville Flour*

*Mills Co. v. Wayne Distrib. Co.*, 171 N.C. 708, 88 S.E. 771 (1916), that breach of a *minor* and *subsidiary* covenant may give rise to an action for damages, but it cannot operate as a discharge.

**§ 25-2-613. Casualty to identified goods.**—Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a “no arrival, no sale” term (§ 25-2-324) then

(a) if the loss is total the contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 7 and 8, Uniform Sales Act.

**Changes:** Rewritten, the basic policy being continued but the test of a “divisible” or “indivisible” sale or contract being abandoned in favor of adjustment in business terms.

**Purposes of changes:**

1. Where goods whose continued existence is presupposed by the agreement are destroyed without fault of either party, the buyer is relieved from his obligation but may at his option take the surviving goods at a fair adjustment. “Fault” is intended to include negligence and not merely wilful wrong. The buyer is expressly given the right to inspect the goods in order to determine whether he wishes to avoid the contract entirely or to take the goods with a price adjustment.

2. The section applies whether the goods were already destroyed at the time of contracting without the knowledge of either party or whether they are destroyed subsequently but before the risk of loss passes to the buyer. Where under the agreement,

including of course usage of trade, the risk has passed to the buyer before the casualty, the section has no application. Beyond this, the essential question in determining whether the rules of this section are to be applied is whether the seller has or has not undertaken the responsibility for the continued existence of the goods in proper condition through the time of agreed or expected delivery.

3. The section on the term “no arrival, no sale” makes clear that delay in arrival, quite as much as physical change in the goods, gives the buyer the options set forth in this section.

**Cross reference:**

Point 3: Section 2—324.

**Definitional cross references:**

“Buyer”. Section 2—103.

“Conform”. Section 2—106.

“Contract”. Section 1—201.

“Fault”. Section 1—201.

“Goods”. Section 2—105.

“Party”. Section 1—201.

“Rights.” Section 1—201.

“Seller”. Section 2—103.

### NORTH CAROLINA COMMENT

There is neither prior statutory nor case law in North Carolina exactly in point with this section. But compare *Stagg*

*v. Spray Water Power & Land Co.*, 171 N.C. 583, 89 S.E. 47 (1916). See North Carolina Comment to GS 25-2-615.

**§ 25-2-614. Substituted performance.** — (1) Where without fault of either party the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive or predatory. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. Subsection (1) requires the tender of a commercially reasonable substituted performance where agreed to facilities have failed or become commercially impracticable. Under this Article, in the absence of specific agreement, the normal or usual facilities enter into the agreement either through the circumstances, usage of trade or prior course of dealing.

This section appears between Section 2—613 on casualty to identified goods and the next section on excuse by failure of presupposed conditions, both of which deal with excuse and complete avoidance of the contract where the occurrence or non-occurrence of a contingency which was a basic assumption of the contract makes the expected performance impossible. The distinction between the present section and those sections lies in whether the failure or impossibility of performance arises in connection with an incidental matter or goes to the very heart of the agreement. The differing lines of solution are contrasted in a comparison of *International Paper Co. v. Rockefeller*, 161 App. Div. 180, 146 N.Y.S. 371 (1914) and *Meyer v. Sullivan*, 40 Cal. App. 723, 181 P. 847 (1919). In the former case a contract for the sale of spruce to be cut from a particular tract of land was involved. When a fire destroyed the trees growing on that tract the seller was held excused since performance was impossible. In the latter case the contract called for delivery of wheat "f.o.b. Kosmos Steamer at Seattle." The war led to cancellation of that line's sailing schedule after space had been duly engaged and the buyer was held entitled to demand substituted delivery at the warehouse on the line's loading dock. Under this Article, of course, the seller would also be entitled, had the

market gone the other way, to make a substituted tender in that manner.

There must, however, be a true commercial impracticability to excuse the agreed to performance and justify a substituted performance. When this is the case a reasonable substituted performance tendered by either party should excuse him from strict compliance with contract terms which do not go to the essence of the agreement.

2. The substitution provided in this section as between buyer and seller does not carry over into the obligation of a financing agency under a letter of credit, since such an agency is entitled to performance which is plainly adequate on its face and without need to look into commercial evidence outside of the documents. See Article 5, especially Sections 5—102, 5—103, 5—109, 5—110 and 5—114.

3. Under subsection (2) where the contract is still executory on both sides, the seller is permitted to withdraw unless the buyer can provide him with a commercially equivalent return despite the governmental regulation. Where, however, only the debt for the price remains, a larger leeway is permitted. The buyer may pay in the manner provided by the regulation even though this may not be commercially equivalent provided that the regulation is not "discriminatory, oppressive or predatory."

#### **Cross reference:**

Point 2: Article 5.

#### **Definitional cross references:**

"Buyer". Section 2—103.

"Fault". Section 1—201.

"Party". Section 1—201.

"Seller". Section 2—103.

#### NORTH CAROLINA COMMENT

There is no prior statutory or case law equivalent in North Carolina.

This section seems to accord, however,

with the reasoning behind *G. Ober & Son v. Smith*, 78 N.C. 313 (1878), that when a purchaser designates no particu-



lar route or carrier by which goods are to be shipped, it is the duty of the sel-

ler to ship the goods in a reasonable course of transit.

§ 25-2-615. **Excuse by failure of presupposed conditions.**—Except so far as a seller may have assumed a greater obligation and subject to the preceding section [§ 25-2-614] on substituted performance:

(a) Delay in delivery or nondelivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

(b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

(c) The seller must notify the buyer seasonably that there will be delay or nondelivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. This section excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting. The destruction of specific goods and the problem of the use of substituted performance on points other than delay or quantity, treated elsewhere in this Article, must be distinguished from the matter covered by this section.

2. The present section deliberately refrains from any effort at an exhaustive expression of contingencies and is to be interpreted in all cases sought to be brought within its scope in terms of its underlying reason and purpose.

3. The first test for excuse under this Article in terms of basic assumption is a familiar one. The additional test of commercial impracticability (as contrasted with "impossibility," "frustration of performance" or "frustration of the venture") has been adopted in order to call attention to the commercial character of the criterion chosen by this Article.

4. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a

contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section. (See *Ford & Sons, Ltd., v. Henry Leatham & Sons, Ltd.*, 21 Com. Cas. 55 (1915, K.B.D.).)

5. Where a particular source of supply is exclusive under the agreement and fails through casualty, the present section applies rather than the provision on destruction or deterioration of specific goods. The same holds true where a particular source of supply is shown by the circumstances to have been contemplated or assumed by the parties at the time of contracting. (See *Davis Co. v. Hoffmann-LaRoche Chemical Works*, 178 App. Div. 855, 166 N.Y.S. 179 (1917) and *International Paper Co. v. Rockefeller*, 161 App. Div. 180, 146 N.Y.S. 371 (1914).) There is no excuse under this section, however, unless the seller has employed all due measures to assure himself that his source will not fail. (See *Canadian Industrial Alcohol Co., Ltd., v. Dunbar Molasses Co.*, 258 N.Y. 194, 179 N.E. 383, 80 A.L.R. 1173 (1932) and *Washington Mfg. Co v. Midland Lumber Co.*, 113 Wash. 593, 194 P. 777 (1921).)

In the case of failure of production by an agreed source for causes beyond the seller's control, the seller should, if possible, be excused since production by an agreed source is without more a basic assumption of the contract. Such excuse should not result in relieving the default-

ing supplier from liability nor in dropping into the seller's lap an unearned bonus of damages over. The flexible adjustment machinery of this Article provides the solution under the provision on the obligation of good faith. A condition to his making good the claim of excuse is the turning over to the buyer of his rights against the defaulting source of supply to the extent of the buyer's contract in relation to which excuse is being claimed.

6. In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this Article is necessary, especially the sections on good faith, on insecurity and assurance and on the reading of all provisions in the light of their purposes, and the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith.

7. The failure of conditions which go to convenience or collateral values rather than to the commercial practicability of the main performance does not amount to a complete excuse. However, good faith and the reason of the present section and of the preceding one may properly be held to justify and even to require any needed delay involved in a good faith inquiry seeking a readjustment of the contract terms to meet the new conditions.

8. The provisions of this section are made subject to assumption of greater liability by agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in trade usage and the like. Thus the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances. (See *Madeirense Do Brasil, S. A. v. Stulman-Emerick Lumber Co.*, 147 F.2d 399 (C.C.A., 2 Cir., 1945).) The exemption otherwise present through usage of trade under the present section may also be expressly negated by the language of the agreement. Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in the light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

Agreement can also be made in regard to the consequences of exemption as laid down in paragraphs (b) and (c) and the next section on procedure on notice claiming excuse.

9. The case of a farmer who has contracted to sell crops to be grown on designated land may be regarded as falling either within the section on casualty to identified goods or this section, and he may be excused, when there is a failure of the specific crop, either on the basis of the destruction of identified goods or because of the failure of a basic assumption of the contract.

Exemption of the buyer in the case of a "requirements" contract is covered by the "Output and Requirements" section both as to assumption and allocation of the relevant risks. But when a contract by a manufacturer to buy fuel or raw material makes no specific reference to a particular venture and no such reference may be drawn from the circumstances, commercial understanding views it as a general deal in the general market and not conditioned on any assumption of the continuing operation of the buyer's plant. Even when notice is given by the buyer that the supplies are needed to fill a specific contract of a normal commercial kind, commercial understanding does not see such a supply contract as conditioned on the continuance of the buyer's further contract for outlet. On the other hand, where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption as, for instance, a war procurement sub-contract known to be based on a prime contract which is subject to termination, or a supply contract for a particular construction venture, the reason of the present section may well apply and entitle the buyer to the exemption.

10. Following its basic policy of using commercial practicability as a test for excuse, this section recognizes as of equal significance either a foreign or domestic regulation and disregards any technical distinctions between "law," "regulation," "order" and the like. Nor does it make the present action of the seller depend upon the eventual judicial determination of the legality of the particular governmental action. The seller's good faith belief in the validity of the regulation is the test under this Article and the best evidence of his good faith is the general commercial acceptance of the regulation. However, governmental interference cannot excuse unless it truly "supervenes" in such a manner as to be beyond the seller's assumption

of risk. And any action by the party claiming excuse which causes or colludes in inducing the governmental action preventing his performance would be in breach of good faith and would destroy his exemption.

11. An excused seller must fulfill his contract to the extent which the supervening contingency permits, and if the situation is such that his customers are generally affected he must take account of all in supplying one. Subsections (a) and (b), therefore, explicitly permit in any proration a fair and reasonable attention to the needs of regular customers who are probably relying on spot orders for supplies. Customers at different stages of the manufacturing process may be fairly treated by including the seller's manufacturing requirements. A fortiori, the seller may also take account of contracts later in date than the one in question. The fact that such spot orders may be closed at an advanced price causes no difficulty, since any allocation which exceeds normal past requirements will not be reasonable. However, good faith requires, when prices have advanced, that the seller exercise real care in making his allocations, and in case of

doubt his contract customers should be favored and supplies prorated evenly among them regardless of price. Save for the extra care thus required by changes in the market, this section seeks to leave every reasonable business leeway to the seller.

**Cross references:**

Point 1: Sections 2—613 and 2—614.

Point 2: Section 1—102.

Point 5: Sections 1—203 and 2—613.

Point 6: Sections 1—102, 1—203 and 2—609.

Point 7: Section 2—614.

Point 8: Sections 1—201, 2—302 and 2—616.

Point 9: Sections 1—102, 2—306 and 2—613.

**Definitional cross references:**

"Between merchants". Section 2—104.

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Good faith". Section 1—201.

"Merchant". Section 2—104.

"Notifies". Section 1—201.

"Seasonably". Section 1—204.

"Seller". Section 2—103.

**NORTH CAROLINA COMMENT**

*Subsection (a)* seems to accord with prior North Carolina contracts principles that if a party by contract charges himself with an obligation possible to be performed, he must make it good, unless its performance be rendered impossible by an act of God, the law, or the other party, and unforeseen difficulties will not excuse him. However, if the parties contract with reference to specific property, the continued existence of which is clearly contemplated by the obligations assumed, the parties are relieved from further obligations concerning property when it is accidentally lost or destroyed by fire or otherwise, rendering performance of the contract impossible. But in order for a party to avail himself of such position, he must show that the destruction of the specific thing was without his fault. See

*Stagg v. Spray Water Power & Land Co.*, 171 N.C. 583, 89 S.E. 47 (1916); *Sale v. State Highway & Pub. Works Comm'n*, 242 N.C. 612, 89 S.E.2d 290 (1955); *Blount-Midyette & Co. v. Aeroglide Corp.*, 254 N.C. 484, 119 S.E.2d 225 (1961). This is also the rule set out in *Taylor v. Caldwell*, 3 Best & S. 826 (1863), a widely followed English case.

*Subsection (b)* is entirely new. There is no statutory or decisional parallel to this subsection in prior North Carolina law which allows seller to make prorata distribution to customers in the event of partial impossibility of performance. Compare *Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co.*, 134 N.C. 574, 47 S.E. 116 (1904).

*Subsection (c)* has no prior North Carolina statutory or decisional parallel. New.

**§ 25-2-616. Procedure on notice claiming excuse.**—(1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section [§ 25-2-615] he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this article relating to breach of installment contracts (§ 25-2-612), then also as to the whole,

(a) terminate and thereby discharge any unexecuted portion of the contract; or



(b) modify the contract by agreeing to take his available quota in substitution.

(2) If after receipt of such notification from the seller the buyer fails so to modify the contract within a reasonable time not exceeding thirty days the contract lapses with respect to any deliveries affected.

(3) The provisions of this section may not be negated by agreement except insofar as the seller has assumed a greater obligation under the preceding section [§ 25-2-615]. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

This section seeks to establish simple and workable machinery for providing certainty as to when a supervening and excusing contingency "excuses" the delay, "discharges" the contract, or may result in a waiver of the delay by the buyer. When the seller notifies, in accordance with the preceding section, claiming excuse, the buyer may acquiesce, in which case the contract is so modified. No consideration is necessary in a case of this kind to support such a modification. If the buyer does not elect so to modify the contract, he may terminate it and under subsection (2) his silence after receiving the seller's claim of excuse operates as such a

termination. Subsection (3) denies effect to any contract clause made in advance of trouble which would require the buyer to stand ready to take delivery whenever the seller is excused from delivery by unforeseen circumstances.

**Cross references:**

Point 1: Sections 2—209 and 2—615.

**Definitional cross references:**

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Installment contract". Section 2—612.

"Notification". Section 1—201.

"Reasonable time". Section 1—204.

"Seller". Section 2—103.

"Termination". Section 2—106.

"Written". Section 1—201.

#### NORTH CAROLINA COMMENT

The procedures established by this section implement the rules established under GS 25-2-614 and 25-2-615. There is no

comparable prior statute or case law in North Carolina.

### PART 7.

#### REMEDIES.

§ 25-2-701. Remedies for breach of collateral contracts not impaired.—Remedies for breach of any obligation or promise collateral or ancillary to a contract for sale are not impaired by the provisions of this article. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

Whether a claim for breach of an obligation collateral to the contract for sale requires separate trial to avoid confusion of issues is beyond the scope of this Article; but contractual arrangements which

as a business matter enter vitally into the contract should be considered a part thereof insofar as cross-claims or defenses are concerned.

**Definitional cross references:**

"Contract for sale". Section 2—106.

"Remedy". Section 1—201.

#### NORTH CAROLINA COMMENT

This section appears to limit the scope of the sales article to parts of a contract

related to the sale of goods and would seem to require no comment.

§ 25-2-702. Seller's remedies on discovery of buyer's insolvency.—(1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this article (§ 25-2-705).

(2) Where the seller discovers that the buyer has received goods on credit while

insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten-day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this article (§ 25-2-403). Successful reclamation of goods excludes all other remedies with respect to them. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Subsection (1)—Sections 53(1) (b), 54(1) (c) and 57, Uniform Sales Act; Subsection (2)—none; Subsection (3)—Section 76(3), Uniform Sales Act.

**Changes:** Rewritten, the protection given to a seller who has sold on credit and has delivered goods to the buyer immediately preceding his insolvency being extended.

**Purposes of changes and new matter:** To make it clear that:

1. The seller's right to withhold the goods or to stop delivery except for cash when he discovers the buyer's insolvency is made explicit in subsection (1) regardless of the passage of title, and the concept of stoppage has been extended to include goods in the possession of any bailee who has not yet attorned to the buyer.

2. Subsection (2) takes as its base line the proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore is fraudulent as against the particular seller. This Article makes discovery of the buyer's insolvency and demand within a ten day period a condition of the right to reclaim goods on this ground. The ten day limitation period operates from the time of receipt of the goods.

An exception to this time limitation is made when a written misrepresentation of solvency has been made to the particular seller within three months prior to the delivery. To fall within the exception the statement of solvency must be in writing, addressed to the particular seller and dated within three months of the delivery.

3. Subsection (3) subjects the right of reclamation to certain rights of third parties "under this Article (Section 2—403)." The rights so given priority of course include the rights given to purchasers from the buyer by Section 2—403(1) and (2). They also include other rights arising un-

der Article 2, such as the rights of lien creditors of the buyer under Section 2—326(3) on consignment sales. Moreover, since Section 2—403(4) incorporates by reference rights given to other purchasers and to lien creditors by Articles 6, 7 and 9, such rights have the same priority. "Lien creditor" here has the same meaning as in Section 9—301(3). Thus if a seller retains an unperfected security interest, subordinate under Section 9—301(1) (b) to the rights of a levying creditor of the buyer, his right of reclamation under this section is also subject to the creditor's rights. Purchasers or lien creditors may also have rights not arising under this Article; under Section 1—103 such rights may have priority by virtue of supplementary principles not displaced by this section. See *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960).

Because the right of the seller to reclaim goods under this section constitutes preferential treatment as against the buyer's other creditors, subsection (3) provides that such reclamation bars all his other remedies as to the goods involved.

#### Cross references:

Point 1: Sections 2—401 and 2—705.

Compare Section 2—502.

#### Definitional cross references:

"Buyer". Section 2—103.

"Buyer in ordinary course of business". Section 1—201.

"Contract". Section 1—201.

"Good faith". Section 1—201.

"Goods". Section 2—105.

"Insolvent". Section 1—201.

"Person". Section 1—201.

"Purchaser". Section 1—201.

"Receipt" of goods. Section 2—103.

"Remedy". Section 1—201.

"Rights". Section 1—201.

"Seller". Section 2—103.

"Writing". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1)* accords with principle given to seller who learns of buyer's insolvency before goods are delivered to applicable in right of stoppage in transitu

buyer based on "the plain reason of justice and equity, that one man's goods shall not be applied to the payment of another man's debts." See *Farrell v. Richmond & D.R.R.*, 102 N.C. 390, 9 S.E. 302 (1889).

*Subsection (2)*, which gives a right to the seller to assert a lien on undelivered goods already delivered, is new and changes North Carolina law. If the goods were delivered to the buyer or the carrier had agreed to hold the goods for the buyer, the seller's right of stoppage in transitu, under prior North Carolina law, was lost. See *Williams v. Hodges*, 113 N.C. 36, 18 S.E. 83 (1893). It was also the law in North Carolina that a vendor of personal property had no lien for the purchase money. See *Bafarrah v. Spell*, 178 N.C. 231, 100 S.E. 321 (1919). An insolvent buyer did not have to disclose his insolvency. If, however, the insolvent

buyer misrepresented his solvency and thereafter went into bankruptcy, even under prior North Carolina law, the seller could recover the property. On a sale of goods, induced by fraud on the part of the vendee, the vendor was authorized to reclaim the property, and the title thereto reverted in him. See *Wilson v. White*, 80 N.C. 280 (1878).

*Change:* While insolvency of buyer alone did not allow a seller to reclaim goods under prior law (requiring a misrepresentation that equaled fraud), this section allows the buyer to reclaim, even after delivery, from a buyer who received goods while insolvent. It extends the theory behind stoppage in transitu. Subsection (3) protects purchasers in ordinary course of business, purchasers for value and lien creditors of buyer.

**§ 25-2-703. Seller's remedies in general.**—Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or the whole, then with respect to any goods directly affected and, if the breach is of the whole contract (§ 25-2-612), then also with respect to the whole undelivered balance, the aggrieved seller may

- (a) withhold delivery of such goods;
- (b) stop delivery by any bailee as hereafter provided (§ 25-2-705);
- (c) proceed under the next section [§ 25-2-704] respecting goods still unidentified to the contract;
- (d) resell and recover damages as hereafter provided (§ 25-2-706);
- (e) recover damages for nonacceptance (§ 25-2-708) or in a proper case the price (§ 25-2-709);
- (f) cancel. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** No comparable index section.

**Purposes:**

1. This section is an index section which gathers together in one convenient place all of the various remedies open to a seller for any breach by the buyer. This Article rejects any doctrine of election of remedy as a fundamental policy and thus the remedies are essentially cumulative in nature and include all of the available remedies for breach. Whether the pursuit of one remedy bars another depends entirely on the facts of the individual case.

2. The buyer's breach which occasions the use of the remedies under this section may involve only one lot or delivery of goods, or may involve all of the goods which are the subject matter of the particular contract. The right of the seller to pursue a remedy as to all the goods when the breach is as to only one or more lots is covered by the section on breach in in-

stallment contracts. The present section deals only with the remedies available after the goods involved in the breach have been determined by that section.

3. In addition to the typical case of refusal to pay or default in payment, the language in the preamble, "fails to make a payment due," is intended to cover the dishonor of a check on due presentment, or the non-acceptance of a draft, and the failure to furnish an agreed letter of credit.

4. It should also be noted that this Act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1—106).

**Cross references:**

- Point 2: Section 2—612.
- Point 3: Section 2—325.
- Point 4: Section 1—106.



**Definitional cross references:**

"Aggrieved party". Section 1—201.

"Buyer". Section 2—103.

"Cancellation". Section 2—106.

"Contract". Section 1—201.

"Goods". Section 2—105.

"Remedy". Section 1—201.

"Seller". Section 2—103.

§ 25-2-704. **Seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods.**—(1) An aggrieved seller under the preceding section [§ 25-2-703] may

(a) identify to the contract conforming goods not already identified if at the time he learned of the breach they are in his possession or control;

(b) treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished.

(2) Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for [scrap] or salvage value or proceed in any other reasonable manner. (1965, c. 700, s. 1.)

**Editor's Note.** — The word "scrap," (2), does not appear in the 1965 Session which is enclosed in brackets in subsection Laws.

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 63(3) and 64(4). Uniform Sales Act.

**Changes:** Rewritten, the seller's rights being broadened.

**Purposes of changes:**

1. This section gives an aggrieved seller the right at the time of breach to identify to the contract any conforming finished goods, regardless of their resalability, and to use reasonable judgment as to completing unfinished goods. It thus makes the goods available for resale under the resale section, the seller's primary remedy, and in the special case in which resale is not practicable, allows the action for the price which would then be necessary to give the seller the value of his contract.

2. Under this Article the seller is given express power to complete manufacture or

procurement of goods for the contract unless the exercise of reasonable commercial judgment as to the facts as they appear at the time he learns of the breach makes it clear that such action will result in a material increase in damages. The burden is on the buyer to show the commercially unreasonable nature of the seller's action in completing manufacture

**Cross references:**

Sections 2—703 and 2—706.

**Definitional cross references:**

"Aggrieved party". Section 1—201.

"Conforming". Section 2—106.

"Contract". Section 1—201.

"Goods". Section 2—105.

"Rights". Section 1—201.

"Seller". Section 2—103.

**NORTH CAROLINA COMMENT**

*Subsections (1) (a) and (b)* allow an aggrieved seller to identify any conforming goods under his control to the contract and to resell the goods intended for particular contract even though unfinished. It was doubtful under prior law whether goods not previously identified or segregated to the contract could, after a repudiation by the buyer, be identified or segregated to lay foundation for a resale for the account of the buyer.

*Subsection (2)* permits the seller to complete goods in manufacture where the completion is commercially reasonable and to resell them so as to fix the damages payable by the buyer where, in a contract calling for the manufacture of goods, the buyer has breached the contract. This subsection apparently changes prior North Carolina law, which in such instances re-

quired the seller-manufacturer to stop manufacture and sue only for the labor expended and expense incurred in the past performance before repudiation, plus the profit that would have accrued had full performance not been prevented by the buyer. See *Novelty Advertising Co. v. Farmer's Mut. Tobacco Warehouse*, 186 N.C. 197, 119 S.E. 196 (1923); *Heiser v. Mears*, 120 N.C. 443, 27 S.E. 117 (1897).

The principal thrust of this UCC provision is that when a contract is repudiated while goods are in an incomplete state in the process of manufacture, the seller-manufacturer, should be permitted to act in good faith in determining by reasonable commercial standards whether to complete manufacture of the goods in process, after buyer's repudiation.

**§ 25-2-705. Seller's stoppage of delivery in transit or otherwise.—**

(1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (§ 25-2-702) and may stop delivery of carload, truckload, planeload or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.

(2) As against such buyer the seller may stop delivery until

(a) receipt of the goods by the buyer; or

(b) acknowledgment to the buyer by any bailee of the goods except a carrier that the bailee holds the goods for the buyer; or

(c) such acknowledgment to the buyer by a carrier by reshipment or as warehouseman; or

(d) negotiation to the buyer of any negotiable document of title covering the goods.

(3) (a) To stop delivery the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages.

(c) If a negotiable document of title has been issued for goods the bailee is not obliged to obey a notification to stop until surrender of the document.

(d) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 57—59, Uniform Sales Act; see also Sections 12, 14 and 42, Uniform Bills of Lading Act and Sections 9, 11 and 49, Uniform Warehouse Receipts Act.

**Changes:** This section continues and develops the above sections of the Uniform Sales Act in the light of the other uniform statutory provisions noted.

**Purposes:** To make it clear that:

1. Subsection (1) applies the stoppage principle to other bailees as well as carriers.

It also expands the remedy to cover the situations, in addition to buyer's insolvency, specified in the subsection. But since stoppage is a burden in any case to carriers, and might be a very heavy burden to them if it covered all small shipments in all these situations, the right to stop for reasons other than insolvency is limited to carload, truckload, planeload or larger shipments. The seller shipping to a buyer of doubtful credit can protect himself by shipping C.O.D.

Where stoppage occurs for insecurity it is merely a suspension of performance, and if assurances are duly forthcoming from the buyer the seller is not entitled to resell or divert.

Improper stoppage is a breach by the seller if it effectively interferes with the buyer's right to due tender under the section on manner of tender of delivery. However, if the bailee obeys an unjusti-

fied order to stop he may also be liable to the buyer. The measure of his obligation is dependent on the provisions of the Documents of Title Article (Section 7—303). Subsection 3(b) therefore gives him a right of indemnity as against the seller in such a case.

2. "Receipt by the buyer" includes receipt by the buyer's designated representative, the sub-purchaser, when shipment is made direct to him and the buyer himself never receives the goods. It is entirely proper under this Article that the seller, by making such direct shipment to the sub-purchaser, be regarded as acquiescing in the latter's purchase and as thus barred from stoppage of the goods as against him.

As between the buyer and the seller, the latter's right to stop the goods at any time until they reach the place of final delivery is recognized by this section.

Under subsection (3)(c) and (d), the carrier is under no duty to recognize the stop order of a person who is a stranger to the carrier's contract. But the seller's right as against the buyer to stop delivery remains, whether or not the carrier is obligated to recognize the stop order. If the carrier does obey it, the buyer cannot complain merely because of that circumstance; and the seller becomes obligated under subsection (3)(b) to pay the carrier any ensuing damages or charges.

3. A diversion of a shipment is not a "reshipment" under subsection (2) (c) when

it is merely an incident to the original contract of transportation. Nor is the procurement of "exchange bills" of lading which change only the name of the consignee to that of the buyer's local agent but do not alter the destination of a re-shipment.

Acknowledgment by the carrier as a "warehouseman" within the meaning of this Article requires a contract of a truly different character from the original shipment, a contract not in extension of transit but as a warehouseman.

4. Subsection (3) (c) makes the bailee's obedience of a notification to stop conditional upon the surrender of any outstanding negotiable document.

5. Any charges or losses incurred by the carrier in following the seller's orders, whether or not he was obligated to do so, fall to the seller's charge.

6. After an effective stoppage under this section the seller's rights in the goods are the same as if he had never made a delivery.

#### Cross references:

Sections 2—702 and 2—703.

Point 1: Sections 2—503 and 2—609, and Article 7.

Point 2: Section 2—103 and Article 7.

#### Definitional cross references:

"Buyer". Section 2—103.

"Contract for sale". Section 2—106.

"Document of title". Section 1—201.

"Goods". Section 2—105.

"Insolvent". Section 1—201.

"Notification". Section 1—201.

"Receipt" of goods. Section 2—103.

"Rights". Section 1—201.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

North Carolina has recognized stoppage in transitu by a seller in the event of a buyer's insolvency. *Farrell v. Richmond & D.R.R.*, 102 N.C. 390, 9 S.E. 302 (1889). If they reached their terminals, however, and were thereafter held by the carrier in storage and the carrier acknowledged to the buyer that it holds the goods for the buyer, the vendor's right to stoppage in transitu was terminated. See *Williams v. Hodges*, 113 N.C. 36, 18 S.E. 83 (1893).

Neither of these principles seems to be affected by this UCC section. However,

it should be noted that under this UCC section, the right of stoppage in transitu is broadened. Stoppage in transitu is available not only when the buyer is insolvent but also upon repudiation by buyer, when a payment is missed, or in any other case the seller has a right to withhold or reclaim the goods.

There are no prior statutes or decisions in North Carolina concerning the further details and procedures relating to stoppages in transit set out in this section of the UCC.

**§ 25-2-706. Seller's resale including contract for resale.**—(1) Under the conditions stated in § 25-2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this article (§ 25-2-710), but less expenses saved in consequence of the buyer's breach.

(2) Except as otherwise provided in subsection (3) or unless otherwise agreed resale may be at public or private sale including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.

(3) Where the resale is at private sale the seller must give the buyer reasonable notification of his intention to resell.

(4) Where the resale is at public sale

(a) only identified goods can be sold except where there is a recognized market for a public sale of futures in goods of the kind; and

(b) it must be made at a usual place or market for public sale if one is reasonably available and except in the case of goods which are perishable or threaten to decline in value speedily the seller must give the buyer reasonable notice of the time and place of the resale; and



(c) if the goods are not to be within the view of those attending the sale the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders; and

(d) the seller may buy.

(5) A purchaser who buys in good faith at a resale takes the goods free of any rights of the original buyer even though the seller fails to comply with one or more of the requirements of this section.

(6) The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (§ 25-2-707) or a buyer who has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as hereinafter defined (subsection (3) of § 25-2-711). (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 60, Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To simplify the prior statutory provision and to make it clear that:

1. The only condition precedent to the seller's right of resale under subsection (1) is a breach by the buyer within the section on the seller's remedies in general or insolvency. Other meticulous conditions and restrictions of the prior uniform statutory provision are disapproved by this Article and are replaced by standards of commercial reasonableness. Under this section the seller may resell the goods after any breach by the buyer. Thus, an anticipatory repudiation by the buyer gives rise to any of the seller's remedies for breach, and to the right of resale. This principle is supplemented by subsection (2) which authorizes a resale of goods which are not in existence or were not identified to the contract before the breach.

2. In order to recover the damages prescribed in subsection (1) the seller must act "in good faith and in a commercially reasonable manner" in making the resale. This standard is intended to be more comprehensive than that of "reasonable care and judgment" established by the prior uniform statutory provision. Failure to act properly under this section deprives the seller of the measure of damages here provided and relegates him to that provided in Section 2-708.

Under this Article the seller resells by authority of law, in his own behalf, for his own benefit and for the purpose of fixing his damages. The theory of a seller's agency is thus rejected.

3. If the seller complies with the prescribed standard of duty in making the resale, he may recover from the buyer the damages provided for in subsection (1). Evidence of market or current prices at any particular time or place is relevant only on the question of whether the seller

acted in a commercially reasonable manner in making the resale.

The distinction drawn by some courts between cases where the title had not passed to the buyer and the seller had resold as owner, and cases where the title had passed and the seller had resold by virtue of his lien on the goods, is rejected.

4. Subsection (2) frees the remedy of resale from legalistic restrictions and enables the seller to resell in accordance with reasonable commercial practices so as to realize as high a price as possible in the circumstances. By "public" sale is meant a sale by auction. A "private" sale may be effected by solicitation and negotiation conducted either directly or through a broker. In choosing between a public and private sale the character of the goods must be considered and relevant trade practices and usages must be observed.

5. Subsection (2) merely clarifies the common law rule that the time for resale is a reasonable time after the buyer's breach, by using the language "commercially reasonable." What is such a reasonable time depends upon the nature of the goods, the condition of the market and the other circumstances of the case; its length cannot be measured by any legal yardstick or divided into degrees. Where a seller contemplating resale receives a demand from the buyer for inspection under the section of preserving evidence of goods in dispute, the time for resale may be appropriately lengthened.

On the question of the place for resale, subsection (2) goes to the ultimate test, the commercial reasonableness of the seller's choice as to the place for an advantageous resale. This Article rejects the theory that the seller is required to resell at the agreed place for delivery and that a resale elsewhere can be permitted only in exceptional cases.

6. The purpose of subsection (2) being to enable the seller to dispose of the goods to the best advantage, he is permitted in

making the resale to depart from the terms and conditions of the original contract for sale to any extent "commercially reasonable" in the circumstances.

7. The provision of subsection (2) that the goods need not be in existence to be resold applies when the buyer is guilty of anticipatory repudiation of a contract for future goods, before the goods or some of them have come into existence. In such a case the seller may exercise the right of resale and fix his damages by "one or more contracts to sell" the quantity of conforming future goods affected by the repudiation. The companion provision of subsection (2) that resale may be made although the goods were not identified to the contract prior to the buyer's breach, likewise contemplates an anticipatory repudiation by the buyer but occurring after the goods are in existence. If the goods so identified conform to the contract, their resale will fix the seller's damages quite as satisfactorily as if they had been identified before the breach.

8. Where the resale is to be by private sale, subsection (3) requires that reasonable notification of the seller's intention to resell must be given to the buyer. The length of notification or a private sale depends upon the urgency of the matter. Notification of the time and place of this type of sale is not required.

Subsection (4) (b) requires that the seller give the buyer reasonable notice of the time and place of a public resale so that he may have an opportunity to bid or to secure the attendance of other bidders. An exception is made in the case of goods "which are perishable or threaten to decline speedily in value."

9. Since there would be no reasonable prospect of competitive bidding elsewhere, subsection (4) requires that a public resale "must be made at a usual place or market for public sale if one is reasonably available;" i. e., a place or market which prospective bidders may reasonably be expected to attend. Such a market may still be "reasonably available" under this subsection, though at a considerable distance from the place where the goods are located. In such a case the expense of transporting the goods for resale is recoverable from the buyer as part of the seller's incidental damages under subsection (1). However, the question of availability is one of commercial reasonableness in the circumstances and if such "usual" place or market is not reasonably available, a duly advertised public resale may be held at another place if it is one which prospective bidders may reasonably be expected to at-

tend, as distinguished from a place where there is no demand whatsoever for goods of the kind.

Paragraph (a) of subsection (4) qualifies the last sentence of subsection (2) with respect to resales of unidentified and future goods at public sale. If conforming goods are in existence the seller may identify them to the contract after the buyer's breach and then resell them at public sale. If the goods have not been identified, however, he may resell them at public sale only as "future" goods and only where there is a recognized market for public sale of futures in goods of the kind.

The provisions of paragraph (c) of subsection 4 are intended to permit intelligent bidding.

The provision of paragraph (d) of subsection (4) permitting the seller to bid and, of course, to become the purchaser, benefits the original buyer by tending to increase the resale price and thus decreasing the damages he will have to pay.

10. This Article departs in subsection (5) from the prior uniform statutory provision in permitting a good faith purchaser at resale to take a good title as against the buyer even though the seller fails to comply with the requirements of this section.

11. Under subsection (6), the seller retains profit, if any, without distinction based on whether or not he had a lien since this Article divorces the question of passage of title to the buyer from the seller's right of resale or the consequences of its exercise. On the other hand, where "a person in the position of a seller" or a buyer acting under the section on buyer's remedies, exercises his right of resale under the present section he does so only for the limited purpose of obtaining cash for his "security interest" in the goods. Once that purpose has been accomplished any excess in the resale price belongs to the seller to whom an accounting must be made as provided in the last sentence of subsection (6).

#### Cross references:

Point 1: Sections 2—610, 2—702 and 2—703.

Point 2: Section 1—201.

Point 3: Sections 2—708 and 2—710.

Point 4: Section 2—328.

Point 8: Section 2—104.

Point 9: Section 2—710.

Point 11: Sections 2—401, 2—707 and 2—711(3).

#### Definitional cross references:

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Good faith". Section 2—103.



"Goods". Section 2—105.

"Merchant". Section 2—104.

"Notification". Section 1—201.

"Person in position of seller". Section 2—707.

"Purchase". Section 1—201.

"Rights". Section 1—201.

"Sale". Section 2—106.

"Security interest". Section 1—201.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

Subsection (1) accords with prior North Carolina law that where a vendee refuses to receive goods, his vendor may resell the goods and hold the original vendee liable for any difference in prices in the first and second sale. See *Hurlburt v. Simpson*, 25 N.C. 233 (1842). The seller in such cases is also entitled to recover for incidental costs of storage, interest and an allowance for time spent acting as buyer's agent in reselling the goods. See *Vanstory Clothing Co. v. Stadiem*, 149 N.C. 6, 62 S.E. 778 (1908). See *Merrill v. Tew*, 183 N.C. 172, 110 S.E. 850 (1922), which indicates that in North Carolina the vendor needed only to exercise reasonable care, skill, and prudence in effecting a resale when the buyer had breached his contract to receive the goods contracted for. This section of the UCC accords generally with North Carolina law which previously allowed the seller to resell upon a buyer's breach, such sale to be in accordance with reasonable commercial practices so as to realize the

best price practicable under the circumstances and so as to fix damages.

The remaining subsections allow both private and public sales and set out details of notice and requirements if public sale is held. The section of the UCC is new to this extent.

Subsection (6) may conflict with prior North Carolina law in that it provides that a seller making a resale need not account to the buyer for any profit made on resale. Under prior law if the seller resold, it was for the account of the buyer as agent if title had passed with the making of the contract. It would seem that in North Carolina under the prior law the buyer as titleholder was entitled to any profits made on resale. He was, of course, under prior law liable for any deficiency. See *Vanstory Clothing Co. v. Stadiem*, 149 N.C. 6, 62 S.E. 778 (1908). This subsection illustrates the basic rejection by the UCC of the necessity of determining the location of title at any given time.

§ 25-2-707. "Person in the position of a seller."—(1) A "person in the position of a seller" includes as against a principal an agent who has paid or become responsible for the price of goods on behalf of his principal or anyone who otherwise holds a security interest or other right in goods similar to that of a seller.

(2) A person in the position of a seller may as provided in this article withhold or stop delivery (§ 25-2-705) and resell (§ 25-2-706) and recover incidental damages (§ 25-2-710). (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 52(2), Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To make it clear that:

In addition to following in general the prior uniform statutory provision, the case of a financing agency which has acquired documents by honoring a letter of credit for the buyer or by discounting a draft for

the seller has been included in the term "a person in the position of a seller."

**Cross reference:**

Article 5, Section 2—506.

**Definitional cross references:**

"Consignee". Section 7—102.

"Consignor". Section 7—102.

"Goods". Section 2—105.

"Security interest". Section 1—201.

"Seller". Section 2—103.

### NORTH CAROLINA COMMENT

This section is designed primarily to allow a financing agency which has acquired documents from the seller to exercise the same rights as the seller in stopping the

goods in transit and reselling the goods upon repudiation and recovering incidental damages. There is no prior North Carolina parallel, either statutory or decisional.

§ 25-2-708. **Seller's damages for nonacceptance or repudiation.**—(1) Subject to subsection (2) and to the provisions of this article with respect to proof of market price (§ 25-2-723), the measure of damages for nonacceptance or repudiation by the buyer is the difference between the market price at the time and



place for tender and the unpaid contract price together with any incidental damages provided in this article (§ 25-2-710), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this article (§ 25-2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 64, Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To make it clear that:

1. The prior uniform statutory provision is followed generally in setting the current market price at the time and place for tender as the standard by which damages for non-acceptance are to be determined. The time and place of tender is determined by reference to the section on manner of tender of delivery, and to the sections on the effect of such terms as FOB, FAS, CIF, C & F, Ex Ship and No Arrival, No Sale.

In the event that there is no evidence available of the current market price at the time and place of tender, proof of a substitute market may be made under the section on determination and proof of market price. Furthermore, the section on the admissibility of market quotations is intended to ease materially the problem of providing competent evidence.

2. The provision of this section permitting recovery of expected profit including reasonable overhead where the standard

measure of damages is inadequate, together with the new requirement that price actions may be sustained only where resale is impractical, are designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods. The normal measure there would be list price less cost to the dealer or list price less manufacturing cost to the manufacturer. It is not necessary to a recovery of "profit" to show a history of earnings, especially if a new venture is involved.

3. In all cases the seller may recover incidental damages.

#### Cross references:

Point 1: Sections 2—319 through 2—324, 2—503, 2—723 and 2—724.

Point 2: Section 2—709.

Point 3: Section 2—710.

#### Definitional cross references:

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Seller". Section 2—103.

#### NORTH CAROLINA COMMENT

Subsection (1) accords with prior North Carolina cases in allowing the seller to recover the difference between the contract price and the market price at the time and place of the breach. See *Cherry v. Upton Co.*, 180 N.C. 1, 103 S.E. 912 (1920); *Bryant v. Southern Box & Lumber Co.*, 192 N.C. 607, 135 S.E. 531 (1926); *Heise v. Mears*, 120 N.C. 443, 27 S.E. 117 (1897).

Subsection (2) also accords with prior North Carolina law where there is a breach of contract and the rule announced in subsection (1) is inadequate (e.g., if the goods are to be manufactured and the buyer repudiates before they are manufactured or before they have value). This subsection, as in prior North Carolina law, allows the seller to recover any profit he would make by full performance after deducting the sum that it would have cost the seller to fully perform. See *Bryant v.*

*Southern Box & Lumber Co.*, 192 N.C. 607, 135 S.E. 531 (1926); *Cleveland-Canton Springs Co. v. Goldsboro Buggy Co.*, 148 N.C. 533, 62 S.E. 637 (1908).

Incidental damages were recoverable in North Carolina by seller upon buyer's breach. See *Vanstory Clothing Co. v. Stadiem*, 149 N.C. 6, 62 S.E. 778 (1908), where storage changed before resale was approved; *Cole & Sons v. Standard Lumber Co.*, 150 N.C. 183, 63 S.E. 736 (1909).

This section does not materially change prior North Carolina law.

(Another example of when subsection (1) would not allow recovery of adequate damages would be a situation where dealer is in business having and selling an unlimited supply of standard priced goods. If a dealer sold a car to buyer, for instance, for \$2,000 list price, and buyer repudiated, under subsection (1) if the seller kept the

car he could not recover from the buyer because the contract price and the value of the car would be the same. Resale will not prove adequate as, by reselling, the seller just makes one sale, whereas, if the buyer

had not repudiated, seller could have made two sales. Subsection (2) cures this defect by allowing the seller to recover the profit on the repudiated sale that he would have obtained had no repudiation occurred.)

**§ 25-2-709. Action for the price.**—(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section [§ 25-2-710], the price

(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (§ 25-2-610), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for nonacceptance under the preceding section [§ 25-2-708]. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

Prior uniform statutory provision: Section 63. Uniform Sales Act.

**Changes:** Rewritten, important commercially needed changes being incorporated.

**Purposes of changes:** To make it clear that:

1. Neither the passing of title to the goods nor the appointment of a day certain for payment is now material to a price action.

2. The action for the price is now generally limited to those cases where resale of the goods is impracticable except where the buyer has accepted the goods or where they have been destroyed after risk of loss has passed to the buyer.

3. This section substitutes an objective test by action for the former "not readily resalable" standard. An action for the price under subsection (1) (b) can be sustained only after a "reasonable effort to resell" the goods "at reasonable price" has actually been made or where the circumstances "reasonably indicate" that such an effort will be unavailing.

4. If a buyer is in default not with respect to the price, but on an obligation to make an advance, the seller should recover not under this section for the price as such, but for the default in the collateral (though coincident) obligation to finance the seller. If the agreement between the parties contemplates that the buyer will acquire, on making the advance, a security interest in the goods, the buyer on making the advance has such an interest as soon

as the seller has rights in the agreed collateral. See Section 9—204.

5. "Goods accepted" by the buyer under subsection (1) (a) include only goods as to which there has been no justified revocation of acceptance, for such a revocation means that there has been a default by the seller which bars his rights under this section. "Goods lost or damaged" are covered by the section on risk of loss. "Goods identified to the contract" under subsection (1) (b) are covered by the section on identification and the section on identification notwithstanding breach.

6. This section is intended to be exhaustive in its enumeration of cases where an action for the price lies.

7. If the action for the price fails, the seller may nonetheless have proved a case entitling him to damages for nonacceptance. In such a situation, subsection (3) permits a recovery of those damages in the same action.

#### Cross references:

Point 4: Section 1—106.

Point 5: Sections 2—501, 2—509, 2—510 and 2—704.

Point 7: Section 2—708.

#### Definitional cross references:

"Action". Section 1—201.

"Buyer". Section 2—103.

"Conforming". Section 2—106.

"Contract". Section 1—201.

"Goods". Section 2—105.

"Seller". Section 2—103.

## NORTH CAROLINA COMMENT

In North Carolina an action for price could not be maintained unless title had passed to the vendee. *Waldo v. Belcher*, 33 N.C. 609 (1850); *Hendricks v. Mocksville Furniture Co.*, 156 N.C. 569, 72 S.E. 592 (1911). This is the common-law rule. See *Williston* §§ 560 (a) and 561.

The UCC in this section specifies on an enumerated basis the instances in which an action for price can be maintained. Location of title is no longer determinative under the Code, which makes it necessary only to determine if one of the enumerated situations has occurred.

Another important matter is a change of emphasis. An action for "price" seems to be rendered secondary to "efforts to re-

sell." Under prior North Carolina law, a seller upon a breach had an option (1) to treat goods as property of buyer and sue for price or (2) to treat the goods as property of the buyer and resell for him and sue for the difference between the contract price and what the goods have brought upon resale. *Vanstory Clothing Co. v. Stadiem*, 149 N.C. 6, 62 S.E. 778 (1908). Under this section of the UCC (subsection (1) (b)), the seller may recover the price only after he is unable to resell them after a reasonable effort. It seems that the Code makes it obligatory to attempt resale whereas heretofore it has been held optional with the seller in North Carolina.

**§ 25-2-710. Seller's incidental damages.**—Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** See Sections 64 and 70, Uniform Sales Act.

**Purposes:** To authorize reimbursement of the seller for expenses reasonably incurred by him as a result of the buyer's breach. The section sets forth the principal normal and necessary additional elements of damage flowing from the breach

but intends to allow all commercially reasonable expenditures made by the seller.

**Definitional cross references:**

"Aggrieved party". Section 1—201.

"Buyer". Section 2—103.

"Goods". Section 2—105.

"Seller". Section 2—103.

## NORTH CAROLINA COMMENT

North Carolina law recognized that seller is entitled to incidental damages and accords with this section of the UCC. See *Vanstory Clothing Co. v. Stadiem*, 149

N.C. 6, 62 S.E. 778 (1908); *Cole & Sons v. Lumber Co.*, 150 N.C. 183, 63 S.E. 736 (1909).

**§ 25-2-711. Buyer's remedies in general; buyer's security interest in rejected goods.**—(1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (§ 25-2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid

(a) "cover" and have damages under the next section [§ 25-2-712] as to all the goods affected whether or not they have been identified to the contract; or

(b) recover damages for nondelivery as provided in this article (§ 25-2-713).

(2) Where the seller fails to deliver or repudiates the buyer may also

(a) if the goods have been identified recover them as provided in this article (§ 25-2-502); or

(b) in a proper case obtain specific performance or replevy the goods as provided in this article (§ 25-2-716).

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (§ 25-2-706). (1965, c. 700, s. 1.)



## OFFICIAL COMMENT

**Prior uniform statutory provision:** No comparable index section; Subsection (3) —Section 69(5), Uniform Sales Act.

**Changes:** The prior uniform statutory provision is generally continued and expanded in Subsection (3).

**Purposes of changes and new matter:**

1. To index in this section the buyer's remedies, subsection (1) covering those remedies permitting the recovery of money damages, and subsection (2) covering those which permit reaching the goods themselves. The remedies listed here are those available to a buyer who has not accepted the goods or who has justifiably revoked his acceptance. The remedies available to a buyer with regard to goods finally accepted appear in the section dealing with breach in regard to accepted goods. The buyer's right to proceed as to all goods when the breach is as to only some of the goods is determined by the section on breach in installment contracts and by the section on partial acceptance.

Despite the seller's breach, proper tender of delivery under the section on cure of improper tender or replacement can effectively preclude the buyer's remedies under this section, except for any delay involved.

2. To make it clear in subsection (3) that the buyer may hold and resell rejected goods if he has paid a part of the price or incurred expenses of the type specified. "Paid" as used here includes acceptance of a draft or other time negotiable instrument or the signing of a negotiable note. His freedom of resale is coextensive with

that of a seller under this Article except that the buyer may not keep any profit resulting from the resale and is limited to retaining only the amount of the price paid and the costs involved in the inspection and handling of the goods. The buyer's security interest in the goods is intended to be limited to the items listed in subsection (3), and the buyer is not permitted to retain such funds as he might believe adequate for his damages. The buyer's right to cover or to have damages for non-delivery, is not impaired by his exercise of his right of resale.

3. It should also be noted that this Act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1—106).

**Cross references:**

Point 1: Sections 2—508, 2—601(c), 2—608, 2—612 and 2—714.

Point 2: Section 2—706.

Point 3: Section 1—106.

**Definitional cross references:**

"Aggrieved party". Section 1—201.

"Buyer". Section 2—103.

"Cancellation". Section 2—106.

"Contract". Section 1—201.

"Cover". Section 2—712.

"Goods". Section 2—105.

"Notifies". Section 1—201.

"Receipt" of goods. Section 2—103.

"Remedy". Section 1—201.

"Security interest". Section 1—201.

"Seller". Section 2—103.

## NORTH CAROLINA COMMENT

*Subsection (1)* accords with prior North Carolina law that upon seller's breach, buyer may cancel contract. See *Hajoca Corp. v. Brooks*, 249 N.C. 10, 105 S.E.2d 123 (1958). Buyer may also recover so much of the purchase price as he has paid. *Robinson v. Huffstetler*, 165 N.C. 459, 81 S.E. 753 (1914).

*Subsection (1) (a)* accords with prior North Carolina law which required the buyer, upon a seller's breach, to make reasonable efforts to protect himself from loss—"to do what reasonable care and business prudence required to minimize the loss." See *Mills v. McRae*, 187 N.C. 707, 122 S.E. 762 (1924), which indicates that a buyer was chargeable with the duty to attempt to purchase goods of similar quantity and quality in the open market to fix buyer's damages in the event of seller's breach. The burden was on the seller to

show that the buyer could have minimized his damages by such "cover" purchase.

*Subsection (1) (b)* accords with prior law. See *Berbarry v. Tombacher*, 162 N.C. 497, 77 S.E. 412 (1913); *Morrison & Hill v. Marks*, 178 N.C. 429, 100 S.E. 890 (1919); *Mills v. McRae*, 187 N.C. 707, 122 S.E. 762 (1924).

*Subsections (2) (a) and (2) (b)*, allowing buyer to recover the goods themselves upon nondelivery or repudiation, accords with *Hughes v. Knott*, 140 N.C. 550, 53 S.E. 361 (1906), which indicates that if a seller breached a contract to deliver specified goods and the buyer could show that he was ready, willing and able to perform, the buyer could maintain an action to recover the goods themselves. See also *Hughes v. Knott*, 138 N.C. 105, 50 S.E. 586 (1905).

*Subsection (3)*, giving buyer a lien on

goods for payments made on the price and expenses incurred when the buyer rightfully rejects goods, apparently has no prior statutory or decisional counterpart in North Carolina law. There is likewise ap-

parently no prior law setting out the buyer's right to resell goods rightfully rejected by the buyer, and thus subsection (3) constitutes new material.

**§ 25-2-712. "Cover"; buyer's procurement of substitute goods.—**

(1) After a breach within the preceding section [§ 25-2-711] the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (§ 25-2-715), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. This section provides the buyer with a remedy aimed at enabling him to obtain the goods he needs thus meeting his essential need. This remedy is the buyer's equivalent of the seller's right to resell.

2. The definition of "cover" under subsection (1) envisages a series of contracts or sales, as well as a single contract or sale; goods not identical with those involved but commercially usable as reasonable substitutes under the circumstances of the particular case; and contracts on credit or delivery terms differing from the contract in breach, but again reasonable under the circumstances. The test of proper cover is whether at the time and place the buyer acted in good faith and in a reasonable manner, and it is immaterial that hindsight may later prove that the method of cover used was not the cheapest or most effective.

The requirement that the buyer must cover "without unreasonable delay" is not intended to limit the time necessary for him to look around and decide as to how he may best effect cover. The test here is similar to that generally used in this Article as to reasonable time and seasonable action.

3. Subsection (3) expresses the policy that cover is not a mandatory remedy for the buyer. The buyer is always free to choose between cover and damages for non-delivery under the next section.

However, this subsection must be read

in conjunction with the section which limits the recovery of consequential damages to such as could not have been obviated by cover. Moreover, the operation of the section on specific performance of contracts for "unique" goods must be considered in this connection for availability of the goods to the particular buyer for his particular needs is the test for that remedy and inability to cover is made an express condition to the right of the buyer to replevy the goods.

4. This section does not limit cover to merchants, in the first instance. It is the vital and important remedy for the consumer buyer as well. Both are free to use cover: the domestic or non-merchant consumer is required only to act in normal good faith while the merchant buyer must also observe all reasonable commercial standards of fair dealing in the trade, since this falls within the definition of good faith on his part.

**Cross references:**

Point 1: Section 2—706.

Point 2: Section 1—204.

Point 3: Sections 2—713, 2—715 and 2—716.

Point 4: Section 1—203.

**Definitional cross references:**

"Buyer". Section 2—103.

"Contract". Section 1—201.

"Good faith". Section 2—103.

"Goods". Section 2—105.

"Purchase". Section 1—201.

"Remedy". Section 1—201.

"Seller". Section 2—103.

**NORTH CAROLINA COMMENT**

This section accords with prior North Carolina law that buyer, upon learning of

seller's breach of contract in failing to deliver, may procure goods of similar quan-

tity and quality in the open market, and recover the difference between the contract price and the reasonable market price for which the substituted goods are purchased. See *Mills v. McRae*, 187 N.C. 707, 122 S.E. 762 (1924); *Indian Mountain Jellico Coal Co. v. Asheville Ice & Coal Co.*, 134 N.C. 574, 47 S.E. 116 (1904); *Wilson v. Scar-*

*boro*, 169 N.C. 654, 86 S.E. 611 (1915). This section provides a handy label.

This section makes the price paid by the buyer to effect "cover" pursuant to reasonable good faith efforts determinative, rather than "reasonable market value" in the abstract.

**§ 25-2-713. Buyer's damages for nondelivery or repudiation.**—(1) Subject to the provisions of this article with respect to proof of market price (§ 25-2-723), the measure of damages for nondelivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this article (§ 25-2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 67(3), Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:** To clarify the former rule so that:

1. The general baseline adopted in this section uses as a yardstick the market in which the buyer would have obtained cover had he sought that relief. So the place for measuring damages is the place of tender (or the place of arrival if the goods are rejected or their acceptance is revoked after reaching their destination) and the crucial time is the time at which the buyer learns of the breach.

2. The market or current price to be used in comparison with the contract price under this section is the price for goods of the same kind and in the same branch of trade.

3. When the current market price under this section is difficult to prove the section on determination and proof of market price is available to permit a showing of a comparable market price or, where no market price is available, evidence of spot sale prices is proper. Where the unavailability of a market price is caused by a

scarcity of goods of the type involved, a good case is normally made for specific performance under this Article. Such scarcity conditions, moreover, indicate that the price has risen and under the section providing for liberal administration of remedies, opinion evidence as to the value of the goods would be admissible in the absence of a market price and a liberal construction of allowable consequential damages should also result.

4. This section carries forward the standard rule that the buyer must deduct from his damages any expenses saved as a result of the breach.

5. The present section provides a remedy which is completely alternative to cover under the preceding section and applies only when and to the extent that the buyer has not covered.

#### Cross references:

Point 3: Sections 1—106, 2—716 and 2—723.

Point 5: Section 2—712.

#### Definitional cross references:

"Buyer". Section 2—103.

"Contract". Section 1—201

"Seller". Section 2—103.

#### NORTH CAROLINA COMMENT

The cases in North Carolina agree with this section that the measure of damages for nondelivery or breach by seller is the difference between the agreed price in the contract and the market value of the goods at the time and place specified for performance. *Berbarry v. Tombacher*, 162 N.C. 497, 77 S.E. 412 (1913); *Gaston Farmers' Warehouse Co. v. American Agricultural Chem. Co.*, 176 N.C. 509, 97 S.E. 472 (1918); *Indian Mountain Jellico Coal Co.*

*v. Asheville Ice & Coal Co.*, 134 N.C. 574, 47 S.E. 116 (1904).

In addition, the buyer may recover damages arising by reason of special circumstances, if the seller knew of such special circumstances or if such damages were fairly and reasonably within the contemplation of the parties when the contract was made. This section states the standard contract rule of damages. See *Tillinghast-Styles Co. v. Providence Cotton Mills*, 143



N.C. 268, 55 S.E. 621 (1906). As to incidental damages recoverable, see *Waynesville Wood Mfg. Co. v. Berlin Mach. Works*, 144 N.C. 689, 57 S.E. 455 (1907),

where recovery was allowed for expenses incurred to buyer for attempting to make a machine work at the request of the seller.

**§ 25-2-714. Buyer's damages for breach in regard to accepted goods.**—(1) Where the buyer has accepted goods and given notification (subsection (3) of § 25-2-607) he may recover as damages for any nonconformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section [§ 25-2-715] may also be recovered. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 69(6) and (7), Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes:**

1. This section deals with the remedies available to the buyer after the goods have been accepted and the time for revocation of acceptance has gone by. In general this section adopts the rule of the prior uniform statutory provision for measuring damages where there has been a breach of warranty as to goods accepted but goes further to lay down an explicit provision as to the time and place for determining the loss.

The section on deduction of damages from price provides an additional remedy for a buyer who still owes part of the purchase price, and frequently the two remedies will be available concurrently. The buyer's failure to notify of his claim under the section on effects of acceptance, however, operates to bar his remedies under either that section or the present section.

2. The "non-conformity" referred to in subsection (1) includes not only breaches of warranties but also any failure of the seller to perform according to his obligations under the contract. In the case of such non-conformity, the buyer is permitted to recover for his loss "in any manner which is reasonable."

3. Subsection (2) describes the usual, standard and reasonable method of ascertaining damages in the case of breach of warranty but it is not intended as an exclusive measure. It departs from the measure of damages for non-delivery in utilizing the place of acceptance rather than the place of tender. In some cases the two may coincide, as where the buyer signifies his acceptance upon the tender. If, however, the non-conformity is such as would justify revocation of acceptance, the time and place of acceptance under this section is determined as of the buyer's decision not to revoke.

4. The incidental and consequential damages referred to in subsection (3), which will usually accompany an action brought under this section, are discussed in detail in the comment on the next section.

#### Cross references:

Point 1: Compare Section 2—711; Sections 2—607 and 2—717.

Point 2: Section 2—106.

Point 3: Sections 2—608 and 2—713.

Point 4: Section 2—715.

#### Definitional cross references:

"Buyer". Section 2—103.

"Conform". Section 2—106.

"Goods". Section 1—201.

"Notification". Section 1—201.

"Seller". Section 2—103.

#### NORTH CAROLINA COMMENT

*Subsection (1)* accords with *Waynesville Wood Mfg. Co. v. Berlin Mach. Works*, 144 N.C. 689, 57 S.E. 455 (1907), and *Armour Fertilizer Works v. McLawhorn*, 158 N.C. 274, 73 S.E. 883 (1912), that when goods are deficient in quality, the damages sustained is the difference between the value of the goods actually sold

and what the value should have been had the terms of the contract been met plus only such damages as were within the contemplation of the parties at the time the contract was made.

*Subsection (2)* accords with *Grossman v. Johnson*, 242 N.C. 571, 89 S.E.2d 141 (1955); *Harris v. Canady*, 236 N.C. 613, 73

S.E.2d 559 (1952); *Hendrix v. B & L Motors, Inc.*, 241 N.C. 644, 86 S.E.2d 448 (1955), that the measure of damages for breach of a warranty in the sale of personal property is the difference between the market value at the time and place of delivery of the goods and the value of the goods as they would have been had they complied with the warranty, with such

special damages as were within the contemplation of the parties, including any expenses reasonably incurred in attempting to make the goods conform. See *Gulf States Creosoting Co. v. Loving*, 120 F.2d 195 (4th Cir. 1941).

*Subsection (3)* accords with prior North Carolina law. See *Harris v. Canady*, 236 N.C. 613, 73 S.E.2d 559 (1952).

### § 25-2-715. Buyer's incidental and consequential damages.—

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provisions:** Subsection (2) (b)—Sections 69(7) and 70, Uniform Sales Act.

**Changes:** Rewritten.

**Purposes of changes and new matter:**

1. Subsection (1) is intended to provide reimbursement for the buyer who incurs reasonable expenses in connection with the handling of rightfully rejected goods or goods whose acceptance may be justifiably revoked, or in connection with effecting cover where the breach of the contract lies in non-conformity or non-delivery of the goods. The incidental damages listed are not intended to be exhaustive but are merely illustrative of the typical kinds of incidental damage.

2. Subsection (2) operates to allow the buyer, in an appropriate case, any consequential damages which are the result of the seller's breach. The "tacit agreement" test for the recovery of consequential damages is rejected. Although the older rule at common law which made the seller liable for all consequential damages of which he had "reason to know" in advance is followed, the liberality of that rule is modified by refusing to permit recovery unless the buyer could not reasonably have prevented the loss by cover or otherwise. Subparagraph (2) carries forward the provisions of the prior uniform statutory provision as to consequential damages resulting from breach of warranty, but modifies the rule by requiring first that the buyer attempt to minimize his

damages in good faith, either by cover or otherwise.

3. In the absence of excuse under the section on merchant's excuse by failure of presupposed conditions, the seller is liable for consequential damages in all cases where he had reason to know of the buyer's general or particular requirements at the time of contracting. It is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part, nor is his obligation for consequential damages limited to cases in which he fails to use due effort in good faith.

Particular needs of the buyer must generally be made known to the seller while general needs must rarely be made known to charge the seller with knowledge.

Any seller who does not wish to take the risk of consequential damages has available the section on contractual limitation of remedy.

4. The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances.

5. Subsection (2) (b) states the usual rule as to breach of warranty, allowing recovery for injuries "proximately" resulting from the breach. Where the injury involved follows the use of goods without discovery of the defect causing the dam-

age, the question of "proximate" cause turns on whether it was reasonable for the buyer to use the goods without such inspection as would have revealed the defects. If it was not reasonable for him to do so, or if he did in fact discover the defect prior to his use, the injury would not proximately result from the breach of warranty.

6. In the case of sale of wares to one in the business of reselling them, resale is one of the requirements of which the seller has reason to know within the meaning of subsection (2) (a).

#### NORTH CAROLINA COMMENT

This section generally restates prior North Carolina law.

*Subsection (1)* accords with prior North Carolina law that incidental and consequential damages for breach of contract which are within the contemplation of the parties are recoverable by buyer from the seller. See *Neal v. Pender-Hyman Hardware Co.*, 122 N.C. 104, 29 S.E. 96 (1898); *Lambert Hoisting Engine Co. v. Paschall*, 151 N.C. 27, 65 S.E. 523 (1909). Remote and speculative damages or damages beyond the contemplation of the parties are

#### Cross references:

Point 1: Section 2—608.

Point 3: Sections 1—203, 2—615 and 2—719.

Point 4: Section 1—106.

#### Definitional cross references:

"Cover". Section 2—712.

"Goods". Section 1—201.

"Person". Section 1—201.

"Receipt" of goods. Section 2—103.

"Seller". Section 2—103.

not recoverable. *Armour Fertilizer Works v. McLawhorn*, 158 N.C. 274, 73 S.E. 883 (1912).

*Subsections (2) (a) and (b)* accord with prior North Carolina law. See, e.g., *Harris v. Canady*, 236 N.C. 613, 73 S.E.2d 559 (1952); *Hanrahan v. Walgreen Co.*, 243 N.C. 268, 90 S.E.2d 392 (1955), that a buyer has a right to recover incidental, consequential or foreseeable damages which are the proximate result of a breach of warranty. *Davis v. Radford*, 233 N.C. 283, 63 S.E.2d 822 (1951).

#### § 25-2-716. Buyer's right to specific performance or replevin.—

(1) Specific performance may be decreed where the goods are unique.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

Prior uniform statutory provision: Section 68, Uniform Sales Act.

Changes: Rephrased.

Purposes of changes: To make it clear that:

1. The present section continues in general prior policy as to specific performance and injunction against breach. However, without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale.

2. In view of this Article's emphasis on the commercial feasibility of replacement, a new concept of what are "unique" goods is introduced under this section. Specific performance is no longer limited to goods which are already specific or ascertained

at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted "in other proper circumstances" and inability to cover is strong evidence of "other proper circumstances".

3. The legal remedy of replevin is given the buyer in cases in which cover is reasonably unavailable and goods have been identified to the contract. This is in addi-



tion to the buyer's right to recover identified goods on the seller's insolvency (Section 2—502).

4. This section is intended to give the buyer rights to the goods comparable to the seller's rights to the price.

5. If a negotiable document of title is outstanding, the buyer's right of replevin relates of course to the document not directly to the goods. See Article 7, especially Section 7—602.

#### Cross references:

Point 3: Section 2—502.

Point 4: Section 2—709.

Point 5: Article 7.

#### Definitional cross references:

"Buyer". Section 2—103.

"Goods". Section 1—201.

"Rights". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsections (1) and (2)* spell out by statute that specific performance may be decreed as to contracts for the sale of goods. Prior North Carolina law provided generally that no specific performance of contracts relating to personal property would be compelled. *Virginia Trust Co. v. Webb*, 206 N.C. 247, 173 S.E. 598 (1934); *Tobacco Growers Ass'n v. Battle*, 187 N.C. 260, 121 S.E. 629 (1924). However, even in North Carolina, the court granted specific performance where damages at law for breach would not afford a complete remedy. *Virginia Trust Co. v. Webb*, 206 N.C. 247, 173 S.E. 598 (1934); *Misenheimer v. Alexander*, 162 N.C. 226, 78 S.E. 161 (1913); *Williams v. Howard*, 7 N.C. 74 (1819).

The Code gives the court more leeway

in granting specific performance of personal property sales contracts "in other proper circumstances."

*Note*: Subsection (3) refers to the old action of replevin which is now "claim and delivery" under North Carolina statute (GS 1-472).

It seems that "claim and delivery" could, under prior North Carolina law, be employed to obtain the subject matter of a contract for the sale of personal property if legal title to the property had passed. See *Holmes v. Godwin*, 69 N.C. 467 (1873).

The UCC does not require any determination of "title" as a condition precedent but allows the buyer to replevy specific goods identified to a contract in the event that "cover" cannot be reasonably effected.

**§ 25-2-717. Deduction of damages from the price.**—The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** See Section 69(1) (a), Uniform Sales Act.

#### Purposes:

1. This section permits the buyer to deduct from the price damages resulting from any breach by the seller and does not limit the relief to cases of breach of warranty as did the prior uniform statutory provision. To bring this provision into application the breach involved must be of the same contract under which the price in question is claimed to have been earned.

2. The buyer, however, must give notice of his intention to withhold all or part of

the price if he wishes to avoid a default within the meaning of the section on insecurity and right to assurances. In conformity with the general policies of this Article, no formality of notice is required and any language which reasonably indicates the buyer's reason for holding up his payment is sufficient.

#### Cross reference:

Point 2: Section 2—609.

#### Definitional cross references:

"Buyer". Section 2—103.

"Notifies". Section 1—201.

### NORTH CAROLINA COMMENT

This section accords with prior North Carolina law. See *Howie v. Rea*, 70 N.C. 559 (1874), which holds that a buyer is permitted to deduct damages in an action for price where the contract has been breached in part by the seller.

The notice requirement of this section of the UCC, however, is a new innovation.

This section does not affect North Carolina's law of set-off and counterclaim as provided in GS 1-137.

**§ 25-2-718. Liquidation or limitation of damages; deposits.—**

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or

(b) in the absence of such terms, twenty per cent (20%) of the value of the total performance for which the buyer is obligated under the contract or five hundred dollars (\$500.00), whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes

(a) a right to recover damages under the provisions of this article other than subsection (1), and

(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this article on resale by an aggrieved seller (§ 25-2-706). (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. Under subsection (1) liquidated damage clauses are allowed where the amount involved is reasonable in the light of the circumstances of the case. The subsection sets forth explicitly the elements to be considered in determining the reasonableness of a liquidated damage clause. A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses.

2. Subsection (2) refuses to recognize a forfeiture unless the amount of the payment so forfeited represents a reasonable liquidation of damages as determined under subsection (1). A special exception is made in the case of small amounts (20% of the price or \$500, whichever is smaller) deposited as security. No distinction is made between cases in which the payment is to be applied on the price and those in which it is intended as security for per-

formance. Subsection (2) is applicable to any deposit or down or part payment. In the case of a deposit or turn in of goods resold before the breach, the amount actually received on the resale is to be viewed as the deposit rather than the amount allowed the buyer for the trade in. However, if the seller knows of the breach prior to the resale of the goods turned in, he must make reasonable efforts to realize their true value, and this is assured by requiring him to comply with the conditions laid down in the section on resale by an aggrieved seller.

**Cross references:**

Point 1: Section 2—302.

Point 2: Section 2—706.

**Definitional cross references:**

"Aggrieved party". Section 1—201.

"Agreement". Section 1—201.

"Buyer". Section 2—103.

"Goods". Section 2—105.

"Notice". Section 1—201.

"Party". Section 1—201.

"Remedy". Section 1—201.

"Seller". Section 2—103.

"Term". Section 1—201.

**NORTH CAROLINA COMMENT**

*Subsection (1)* accords with the general law applicable in North Carolina as to liquidated damages. See *Crawford v. Allen*, 189 N.C. 434, 127 S.E. 521 (1925), and

*Horn v. Poindexter*, 176 N.C. 620, 97 S.E. 653 (1918), which hold that where there is a marked disproportion between the amount fixed upon as liquidated damages

in the contract and the damages actually likely to arise from a breach so as to render the amount fixed upon unreasonable or oppressive, it is void as being a penalty and it is not binding. The actual damages can be inquired into notwithstanding such provision. If the amount specified is not unjust, oppressive, or disproportionate to the damages that would likely result from

a breach of contract, a provision for liquidated damages would be valid. See *Tobacco Growers Co-op Ass'n v. Jones*, 185 N.C. 265, 117 S.E. 174 (1923).

Subsections (2), (3) and (4) have no prior statutory or decisional parallels in North Carolina law and are therefore new to North Carolina law.

**§ 25-2-719. Contractual modification or limitation of remedy.**—(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section [§ 25-2-718] on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages recoverable under this article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts; and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this chapter.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is *prima facie* unconscionable but limitation of damages where the loss is commercial is not. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:**  
None.

##### Purposes:

1. Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect.

However, it is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for sale within this Article they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion and in that event the remedies made available by this Article are applicable as if the stricken clause had never existed. Similarly, under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.

2. Subsection (1) (b) creates a presumption that clauses prescribing remedies are cumulative rather than exclusive. If the parties intend the term to describe the sole remedy under the contract, this must be clearly expressed.

3. Subsection (3) recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner. Actually such terms are merely an allocation of unknown or undeterminable risks. The seller in all cases is free to disclaim warranties in the manner provided in Section 2—316.

##### Cross references:

Point 1: Section 2—302.

Point 3: Section 2—316.

##### Definitional cross references:

"Agreement". Section 1—201.

"Buyer". Section 2—103.

"Conforming". Section 2—106.

"Contract". Section 1—201.

"Goods". Section 2—105.

"Remedy". Section 1—201.

"Seller". Section 2—103.

#### NORTH CAROLINA COMMENT

*Subsection (1) (a)* accords with prior North Carolina law as expressed in *Allen v. Tompkins*, 136 N.C. 208, 48 S.E. 655 (1904), that the parties to a sales contract



can limit their liability and remedies by the terms of their contract (to making repairs, furnishing other goods, etc.).

*Subsection (1) (b)* has no prior decisional or statutory counterpart in North Carolina law.

*Subsection (2)* has no prior decisional or statutory counterpart in North Carolina law.

*Subsection (3)*: The first sentence of subsection (3) accords, at least in part, with *Hampton Guano Co. v. Live-Stock Co.*, 168 N.C. 442, 84 S.E. 774 (1915), and *Carter v. McGill*, 171 N.C. 775, 89 S.E. 28 (1916), where it is held that a seller may limit his liability by inserting in his sales contract a provision that he shall not be liable for certain results.

The second sentence of subsection (3), making limitations as to consequential damages for injuries to persons *prima facie* unconscionable when goods are consumer goods, has no prior decisional or statutory parallel in North Carolina. The UCC provision does not create a *prima*

*facie* presumption of unconscionability of limitations of liability in commercial contracts.

(*Note*: While it is stated above that there is no prior statutory nor decisional parallel to subsection (3)'s provisions making limitations of liability *prima facie* unconscionable with regard to consumer goods, this subsection (3) in principle in this regard is not unlike the contracts principle that a party cannot protect himself by contract from liability for his own negligence in the performance of a duty of public service, or where a public duty is owed, or public interest is involved, or where public interest requires performance of a private duty. See *Hall v. Sinclair*, 242 N.C. 707, 89 S.E.2d 396 (1955). This subsection seems to clothe sales of consumer goods with a protection against limitations of liability on the part of sellers as a matter of public policy with reference to consumer goods where injuries to the person may be involved.)

**§ 25-2-720. Effect of "cancellation" or "rescission" on claims for antecedent breach.**—Unless the contrary intention clearly appears, expressions of "cancellation" or "rescission" of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purpose:**

This section is designed to safeguard a person holding a right of action from any unintentional loss of rights by the ill-advised use of such terms as "cancellation", "rescission", or the like. Once a party's rights have accrued they are not to be lightly impaired by concessions made in business decency and without intention

to forego them. Therefore, unless the cancellation of a contract expressly declares that it is "without reservation of rights", or the like, it cannot be considered to be a renunciation under this section.

**Cross reference:**

Section 1—107.

**Definitional cross references:**

"Cancellation". Section 2—106.

"Contract". Section 1—201.

#### NORTH CAROLINA COMMENT

There are no prior cases or statutes in North Carolina relating to accidental or unintended consequences as the result of

the misuse of the words "cancel" or "rescind" which this section was designed to remedy. Entirely new material.

**§ 25-2-721. Remedies for fraud.**—Remedies for material misrepresentation or fraud include all remedies available under this article for nonfraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** To correct the situation by which remedies for fraud have been more circumscribed than the more modern and mercantile remedies for breach of war-

ranty. Thus the remedies for fraud are extended by this section to coincide in scope with those for non-fraudulent breach. This section thus makes it clear that neither rescission of the contract for

fraud nor rejection of the goods bars other remedies unless the circumstances of the case make the remedies incompatible.

**Definitional cross references:**

"Contract for sale". Section 2—106.

"Goods". Section 1—201.

"Remedy". Section 1—201.

**NORTH CAROLINA COMMENT**

The second sentence of this section makes a fundamental change in North Carolina law.

Under prior North Carolina law if a person discovered that he had been induced to buy goods by the actionable fraud of another, he might elect to choose between two inconsistent courses with reference to his purchase. He might either affirm the contract or repudiate it. But he could not do both, either in whole or in part. He might rescind, place the seller in status quo, and recover any portion of the purchase price which he might have paid. Or he might elect to affirm the contract, retain whatever advantage he had received.

When he affirmed the contract, it became validated; the purchaser became liable for the purchase price. He might counterclaim or sue in an independent action for damages sustained as a result of the fraud of the seller. See *Hutchins v. Davis*, 230 N.C. 67, 52 S.E.2d 210 (1949).

Under this UCC section the law of North Carolina is changed. Rescission for fraud will no longer ban other remedies unless the particular circumstances of the case make the remedies incompatible. Under this UCC provision, in proper cases, the buyer may both rescind and recover damages.

§ 25-2-722. **Who can sue third parties for injury to goods.**—Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract

(a) a right of action against the third party is in either party to the contract for sale who has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have been destroyed or converted a right of action is also in the party who either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other;

(b) if at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, his suit or settlement is, subject to his own interest, as a fiduciary for the other party to the contract;

(c) either party may with the consent of the other sue for the benefit of whom it may concern. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:** To adopt and extend somewhat the principle of the statutes which provide for suit by the real party in interest. The provisions of this section apply only after identification of the goods. Prior to that time only the seller has a right of action. During the period between identification and final acceptance (except in the case of revocation of acceptance) it is possible for both parties to have the right of action. Even after final acceptance

both parties may have the right of action if the seller retains possession or otherwise retains an interest.

**Definitional cross references:**

"Action". Section 1—201.

"Buyer". Section 2—103.

"Contract for sale". Section 2—106.

"Goods". Section 2—105.

"Party". Section 1—201.

"Rights". Section 1—201.

"Security interest". Section 1—201.

**NORTH CAROLINA COMMENT**

This section apparently changes prior North Carolina law concerning who can bring an action for tortious injury or conversion against a third person. The prior law made "title" determinative. See *Peed*

*v. Burleson's, Inc.*, 244 N.C. 437, 94 S.E.2d 351 (1956). Under this section of the Code a right of action is given to any person who has an insurable interest in the goods.

§ 25-2-723. **Proof of market price; time and place.**—(1) If an action based on anticipatory repudiation comes to trial before the time for performance with respect to some or all of the goods, any damages based on market price (§

25-2-708 or § 25-2-713) shall be determined according to the price of such goods prevailing at the time when the aggrieved party learned of the repudiation.

(2) If evidence of a price prevailing at the times or places described in this article is not readily available the price prevailing within any reasonable time before or after the time described or at any other place which under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the cost of transporting the goods to or from such other place.

(3) Evidence of a relevant price prevailing at a time or place other than the one described in this article offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** To eliminate the most obvious difficulties arising in connection with the determination of market price, when that is stipulated as a measure of damages by some provision of this Article. Where the appropriate market price is not readily available the court is here granted reasonable leeway in receiving evidence of prices current in other comparable markets or at other times comparable to the one in question. In accordance with the general principle of this Article against surprise, however, a party intending to offer evidence of such a substitute

price must give suitable notice to the other party.

This section is not intended to exclude the use of any other reasonable method of determining market price or of measuring damages if the circumstances of the case make this necessary.

#### Definitional cross references:

"Action". Section 1—201.

"Aggrieved party". Section 1—201.

"Goods". Section 2—105.

"Notifies". Section 1—201.

"Party". Section 1—201.

"Reasonable time". Section 1—204.

"Usage of trade". Section 1—205.

### NORTH CAROLINA COMMENT

*Subsection (1)* provides that if an action based on anticipatory breach of contract comes to trial before the time for performance, the measure of damages shall be the difference between the contract price and the price of the goods prevailing at the time the aggrieved party learns of the breach. See GS 25-2-610. This subsection will change the rule in effect previously in North Carolina, that damages for anticipatory breach of contract were to be assessed on the basis of profit factors existent at the time of performance fixed by contract, not at the time of repudiation. See *McJunkin Corp. v. North Carolina Natural Gas Corp.*, 300 F.2d 794 (4th Cir. 1961).

This subsection is designed to obviate difficulties of determining damages in anticipatory breaches.

*Subsections (2) and (3)* apparently change prior North Carolina law. The ordinary rule upon breach of contract is that the measure of damages is the difference between the contract price and market value at the time and place where the goods should have been delivered by the terms of the contract. See, e.g., *Jeanette v. Hovey*, 184 N.C. 140, 113 S.E. 665 (1922);

*Berbarry v. Tombacher*, 162 N.C. 497, 77 S.E. 412 (1913). The UCC provisions establish the admissibility of evidence of market prices at other times and places than the time and place for performance of the contract if such evidence, by usages of trade and commercial judgment, is reasonably relevant in determining the damages for nonperformance at a particular time or place. The substituted market price evidence is only admissible if other evidence of market price is unavailable or not readily available.

This rule is new in North Carolina although North Carolina has previously held that testimony of value of a chattel where there is a market for it, making due allowance for expenses of transportation and sale, may be taken as the basis for ascertaining its value at some other place. See *Suttle v. Falls*, 98 N.C. 393, 4 S.E. 541 (1887). It has also been held that the value of an item within a reasonable time after its conversion or destruction is competent as bearing upon its value at the time it was converted or destroyed. *Newsom v. Gothran*, 185 N.C. 161, 116 S.E. 415 (1923).

**§ 25-2-724. Admissibility of market quotations.**—Whenever the prevailing price or value of any goods regularly bought and sold in any established



commodity market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of such market shall be admissible in evidence. The circumstances of the preparation of such a report may be shown to affect its weight but not its admissibility. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** To make market quotations admissible in evidence while providing for a challenge of the material by showing the circumstances of its preparation.

No explicit provision as to the weight to be given to market quotations is contained in this section, but such quotations, in the absence of compelling challenge, offer an adequate basis for a verdict.

Market quotations are made admissible when the price or value of goods traded "in any established market" is in issue. The reason of the section does not require that the market be closely organized in the manner of a produce exchange. It is sufficient if transactions in the commodity are

frequent and open enough to make a market established by usage in which one price can be expected to affect another and in which an informed report of the range and trend of prices can be assumed to be reasonably accurate.

This section does not in any way intend to limit or negate the application of similar rules of admissibility to other material, whether by action of the courts or by statute. The purpose of the present section is to assure a minimum of mercantile administration in this important situation and not to limit any liberalizing trend in modern law.

**Definitional cross reference:**

"Goods". Section 2—105.

#### NORTH CAROLINA COMMENT

This section accords with prior North Carolina cases permitting evidence as to price or value through commercial circulars, market reports and newspaper price quotations. See *Smith v. North Carolina R.R.*, 68 N.C. 107 (1873); *Fairley v. Smith*, 87 N.C. 367 (1882); *Suttle v. Falls*, 98 N.C. 393, 4 S.E. 541 (1887); *Moseley v. Johnson*, 144 N.C. 257, 56 S.E. 922 (1907), on

the theory that "it is from such sources and by such means that merchants and businessmen generally come to have information and knowledge as to the methods, customs and courses of trade and business, and the market value and current prices of classes of goods, articles, and things put upon and sold in the markets of the country."

**§ 25-2-725. Statute of limitations in contracts for sale.**—(1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

(3) Where an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same breach such other action may be commenced after the expiration of the time limited and within twelve months after the termination of the first action.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this chapter becomes effective. (1965, c. 700, s. 1.)

**Cross Reference.**—As to effective date of this chapter, see § 25-10-101.

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** To introduce a uniform statute of limitations for sales contracts, thus eliminating the jurisdictional variations and providing needed relief for concerns

doing business on a nationwide scale whose contracts have heretofore been governed by several different periods of limitation depending upon the state in which the transaction occurred. This Ar-

ticle takes sales contracts out of the general laws limiting the time for commencing contractual actions and selects a four year period as the most appropriate to modern business practice. This is within the normal commercial record keeping period.

Subsection (1) permits the parties to reduce the period of limitation. The minimum period is set at one year. The parties may not, however, extend the statutory period.

Subsection (2), providing that the cause of action accrues when the breach occurs, states an exception where the warranty extends to future performance.

Subsection (3) states the saving provision included in many state statutes and permits an additional short period for bringing new actions, where suits begun

within the four year period have been terminated so as to leave a remedy still available for the same breach.

Subsection (4) makes it clear that this Article does not purport to alter or modify in any respect the law on tolling of the Statute of Limitations as it now prevails in the various jurisdictions.

**Definitional cross references:**

"Action". Section 1—201.

"Aggrieved party". Section 1—201.

"Agreement". Section 1—201.

"Contract for sale". Section 2—106.

"Goods". Section 2—105.

"Party". Section 1—201.

"Remedy". Section 1—201.

"Term". Section 1—201.

"Termination". Section 2—106.

### NORTH CAROLINA COMMENT

*Subsection (1)* changes prior North Carolina law. Under GS 1-52 an action arising out of a simple, nonsealed contract had a statute of limitations of three years from the accrual of the cause of action. Under GS 1-47 (2) the statute of limitations upon actions arising out of sealed instruments was ten years.

*Subsection (2)*: In addition, a cause of action is made to accrue when a breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. This rule is contrary to that now applicable in North Carolina that in an action based on fraud or mistake, the action must be begun within three years of the discovery of

the fraud but the statute of limitations does not begin to run until the date of the discovery of the fraud or mistake, or from the time it should have been discovered in the exercise of due diligence. See GS 1-52 (9); *Wimberly v. Washington Furniture Stores*, 216 N.C. 732, 6 S.E.2d 512 (1939).

*Subsection (3)* is a saving provision which will preserve existing causes of action which might otherwise be barred by the adoption of the UCC, specifying a time within which such actions must be brought.

*Subsection (4)* preserves the prior law as to tolling of limitations.

### ARTICLE 3.

#### *Commercial Paper.*

### PART 1.

#### SHORT TITLE, FORM AND INTERPRETATION.

**§ 25-3-101. Short title.**—This article shall be known and may be cited as Uniform Commercial Code—Commercial Paper. (1899, c. 733, ss. 128, 191; Rev., ss. 2278, 2340; C. S., ss. 2976, 3110; 1965, c. 700, s. 1.)

**Editor's Note.**—For case law survey on negotiable instruments, see 41 N.C.L. Rev. 496 (1963).

### OFFICIAL COMMENT

This Article represents a complete revision and modernization of the Uniform Negotiable Instruments Law.

The Comments which follow will point out the respects in which this Article changes the Negotiable Instruments Law, which was promulgated by the National

Conference of Commissioners on Uniform State Laws in 1896. and was subsequently enacted in every American jurisdiction. Needless to say, in the 50 odd years of the history of that statute, there have been vast changes in commercial practices relating to the handling of negotiable instru-

ments. The need for revision of this important statute was felt for some years before the present project was undertaken. It should be noted especially that this

Article does not apply in any way to the handling of securities. Article 8 deals with that subject. See Section 3—103.

§ 25-3-102. **Definitions and index of definitions.**—(1) In this article unless the context otherwise requires:

(a) "Issue" means the first delivery of an instrument to a holder or a remitter.

(b) An "order" is a direction to pay and must be more than an authorization or request. It must identify the person to pay with reasonable certainty. It may be addressed to one or more such persons jointly or in the alternative but not in succession.

(c) A "promise" is an undertaking to pay and must be more than an acknowledgment of an obligation.

(d) "Secondary party" means a drawer or endorser.

(e) "Instrument" means a negotiable instrument.

(2) Other definitions applying to this article and the sections in which they appear are:

"Acceptance." § 25-3-410.

"Accommodation party." § 25-3-415.

"Alteration." § 25-3-407.

"Certificate of deposit." § 25-3-104.

"Certification." § 25-3-411.

"Check." § 25-3-104.

"Definite time." § 25-3-109.

"Dishonor." § 25-3-507.

"Draft." § 25-3-104.

"Holder in due course." § 25-3-302.

"Negotiation." § 25-3-202.

"Note." § 25-3-104.

"Notice of dishonor." § 25-3-508.

"On demand." § 25-3-108.

"Presentment." § 25-3-504.

"Protest." § 25-3-509.

"Restrictive indorsement." § 25-3-205.

"Signature." § 25-3-401.

(3) The following definitions in other articles apply to this article:

"Account." § 25-4-104.

"Banking day." § 25-4-104.

"Clearing house." § 25-4-104.

"Collecting bank." § 25-4-105.

"Customer." § 25-4-104.

"Depository bank." § 25-4-105.

"Documentary draft." § 25-4-104.

"Intermediary bank." § 25-4-105.

"Item." § 25-4-104.

"Midnight deadline." § 25-4-104.

"Payor bank." § 25-4-105.

(4) In addition article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. (1965, c. 700, s. 1.)

**Primary and Secondary Liability.** — Joint makers upon the face of a negotiable instrument are deemed to be primarily liable thereon. *Roberson Co. v. Spain*, 173 N.C. 23, 91 S.E. 361 (1917). See also *Taft v. Covington*, 199 N.C. 51, 153 S.E. 597 (1930).

When a promissory note sued on has the

signatures of two of the defendants on its face as joint makers and the other defendant's signature on the back as indorser, they are each liable to the payee and, nothing else appearing, those signing as makers are primarily liable, with the right of contribution among themselves, while the indorser is secondarily liable. *Raleigh*



Trust Co. v. York, 199 N.C. 624, 155 S.E. 263 (1930).

When a married woman has executed a note as co-maker with her husband, a holder in due course for value may accord-

ingly enforce collection thereof against her as a person primarily liable on the note, and absolutely required to pay it. Taft v. Covington, 199 N.C. 51, 153 S.E. 597 (1930).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 1(5), 128 and 191, Uniform Negotiable Instruments Law.

**Changes:** See below.

**Purposes of changes:**

1. The definition of "issue" in Section 191 of the original Act has been clarified in two respects. The Section 191 definition required that the instrument delivered be "complete in form" inconsistently with the provisions of Sections 14 and 15 (relating to incomplete instruments) of the original Act. The "complete in form" language has therefore been deleted. Furthermore the Section 191 definition required that the delivery be "to a person who takes as a holder", thus raising difficulties in the case of the remitter (see Comment 3 to Sec. 3—302) who may not be a party to the instrument and thus not a holder. The definition in subsection (1) (a) of this section thus provides that the delivery may be to a holder or to a remitter.

2. The definitions of "order" [subsection (b)] and "promise" [subsection (c)] are new, but state principles clearly recognized by the courts. In the case of orders the dividing line between "a direction to pay" and "an authorization or request" may not be self-evident in the occasional, unusual, and therefore non-commercial, case. The prefixing of words of courtesy to the direction—as "please pay" or "kindly pay"—should not lead to a holding that the direction has degenerated into a mere request. On the other hand informal language—such as "I wish you would pay"—would not qualify as an order and such an instrument would be non-negotiable.

The definition of "promise" is intended to make it clear that a mere I.O.U. is not a negotiable instrument, and to change the result in occasional cases which have held that "Due Currier & Barker seventeen dollars and fourteen cents, value received," and "I borrowed from P. Shemonia the sum of five hundred dollars with four per cent interest; the borrowed money ought to be paid within four months from the above date" were promises sufficient to make the instruments into notes.

3. The last sentence of subsection (1) (b) ("order") permits the order to be addressed to one or more persons (as drawees) in the alternative, recognizing the practice of corporations issuing dividend checks and of other drawers who for commercial convenience name a number of drawees, usually in different parts of the country. The section on presentment provides that presentment may be made to any one of such drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment, and upon the first dishonor should have his recourse against the drawer and indorsers.

4. Comments on the definitions indexed follow the sections in which the definitions are contained.

#### Cross reference:

Point 3: Section 3—504(3) (a).

#### Definitional cross references:

"Bank". Section 1—201.

"Delivery". Section 1—201.

"Holder". Section 1—201.

"Money". Section 1—201.

"Person". Section 1—201.

### NORTH CAROLINA COMMENT

The principal change of this section relates to the permissibility of using alternative drawees. NIL 128 (GS 25-135) did not permit an order to be addressed to two or more drawees in the alternative. The new section permits this, thus recognizing current commercial practice where-

by corporations issuing dividend checks (and certain other drawers) name a number of drawee banks often in different parts of the country.

The Official Comments explain certain other very minor changes.

**§ 25-3-103. Limitations on scope of article.**—(1) This article does not apply to money, documents of title or investment securities.

(2) The provisions of this article are subject to the provisions of the article on bank deposits and collections (article 4) and secured transactions (article 9). (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. This Article is restricted to commercial paper—that is to say to drafts, checks, certificates of deposit and notes as defined in Section 3—104(2). Subsection (1) expressly excludes any money, as defined in this Act (Section 1—201), even though the money may be in the form of a bank note which meets all the requirements of Section 3—104(1). Money is of course negotiable at common law or under separate statutes, but no provision of this Article is applicable to it. Subsection (1) also expressly excludes documents of title and investment securities which fall within Articles 7 and 8, respectively. To this extent the section follows decisions which held that interim certificates calling for the delivery of securities were not negotiable instruments under the original statute. Such paper is now covered under Article 8, but is not within any section of this Article. Likewise, bills of lading, warehouse receipts and other documents of title which fall within Article 7 may be negotiable under the provision of that Article, but are not covered by any section of this Article.

2. Instruments which fall within the scope of this Article may also be subject to other Articles of the Code. Many items in course of bank collection will of course be negotiable instruments, and the same may be true of collateral pledged as security for a debt. In such cases this Article, which is general, is, in case of conflicting provisions, subject to the Articles which

deal specifically with the type of transaction or instrument involved: Article 4 (Bank Deposits and Collections) and Article 9 (Secured Transactions). In the case of a negotiable instrument which is subject to Article 4 because it is in course of collection or to Article 9 because it is used as collateral, the provisions of this Article continue to be applicable except insofar as there may be conflicting provisions in the Bank Collection or Secured Transactions Article.

An instrument which qualifies as “negotiable” under this Article may also qualify as a “security” under Article 8. It will be noted that the formal requisites of negotiability (Section 3—104) go to matters of form exclusively; the definition of “security” on the other hand (Section 8—102) looks principally to the manner in which an instrument is used (“commonly dealt in upon securities exchanges . . . or commonly recognized . . . as a medium for investment”). If an instrument negotiable in form under Section 3—104 is, because of the manner of its use, a “security” under Section 8—102, Article 8 and not this Article applies. See subsection (1) of this section and Section 8—102(1)(b).

**Cross references:**

Point 1: Articles 7 and 8; Sections 1—201, 3—104(1) and (2), 3—107.

Point 2: Articles 4 and 9; Sections 3—104 and 8—102.

**Definitional cross references:**

“Document of title”. Section 1—201.

“Money”. Section 1—201.

## NORTH CAROLINA COMMENT

This section limits the application of article 3 to commercial paper (e.g., checks, drafts, promissory notes, and certificates of deposit). Other types of paper are governed by other articles:

Article 5—Letters of credit;

Article 7—Bills of lading, warehouse receipts, and other documents of title;

Article 8—Investment securities.

The section also specifies that the provisions of article 3 are “subject to” the provisions of article 4 (bank deposits and collections) and to article 9 (secured transactions).

It is important to note here that to the extent that commercial paper comes into the regular stream of bank deposits and collections, the provisions of article 4 are of great importance; and the special provisions of article 4 will prevail over the more general provisions of article 3; thus, these two major articles must often be consulted in order fully to determine the rights and duties of parties on negotiable instruments.

**§ 25-3-104. Form of negotiable instruments; “draft”; “check”; “certificate of deposit”; “note.”—**(1) Any writing to be a negotiable instrument within this article must

(a) be signed by the maker or drawer; and

(b) contain an unconditional promise or order to pay a sum certain in money

and no other promise, order, obligation or power given by the maker or drawer except as authorized by this article; and

(c) be payable on demand or at a definite time; and

(d) be payable to order or to bearer.

(2) A writing which complies with the requirements of this section is

(a) a "draft" ("bill of exchange") if it is an order;

(b) a "check" if it is a draft drawn on a bank and payable on demand;

(c) a "certificate of deposit" if it is an acknowledgment by a bank of receipt of money with an engagement to repay it;

(d) a "note" if it is a promise other than a certificate of deposit.

(3) As used in other articles of this chapter, and as the context may require, the terms "draft," "check," "certificate of deposit" and "note" may refer to instruments which are not negotiable within this article as well as to instruments which are so negotiable. (1899, c. 733, ss. 1, 5, 10, 126, 184, 185, 197; 1905, c. 327; Rev., ss. 2151, 2154, 2160, 2276, 2334, 2335, 2346; C. S., ss. 2982, 2986, 2991, 3108, 3166, 3167; 1965, c. 700, s. 1.)

**Obligation in Addition to Paying Money Destroys Negotiability.** — A bond to pay money, and to do something else, "as to feed and clothe a slave," is not negotiable. *Knight v. Wilmington & M.R.R.*, 46 N.C. 357 (1854).

**As Does Condition.**—A contingent condition has always defeated the negotiability of an instrument. *Goodloe v. Taylor*, 10 N.C. 458 (1825).

After the passage of the NIL, the court held that a note, the payment of which was made dependent upon a condition expressed in a separate instrument, a deed, was not negotiable. *Pope v. Righter Parey Lumber Co.*, 162 N.C. 206, 78 S.E. 65 (1913).

**Thus, Conditional Promise or Uncertain Sum Renders Note Nonnegotiable.** — To render a note nonnegotiable it must show on its face that the promise to pay is conditional, or render the amount to be paid uncertain. *First Nat'l Bank v. Michael*, 96 N.C. 53, 1 S.E. 855 (1887).

**Note Not Payable to Order or Bearer Is Not Negotiable.**—A note not payable to order or bearer is not a negotiable paper. *Newland v. Moore*, 173 N.C. 728, 92 S.E. 367 (1917).

Where an instrument is expressly made payable to a named person, such a provision clearly imports a lack of negotiability under this section. *Bank of United States v. Cuthbertson*, 67 F.2d 182 (4th Cir. 1933).

The absence of the words "to bearer" or "to order" does not render bonds non-assignable, but nonnegotiable. *Bank of United States v. Cuthbertson*, 67 F.2d 182 (4th Cir. 1933).

Unless a note is payable to the order of a special person or to bearer it is not negotiable. *Johnson v. Lassiter*, 155 N.C. 47, 71 S.E. 23 (1911).

**But note payable to a specific person or**

**his order is negotiable.** *Price Real Estate & Ins. Co. v. Jones*, 191 N.C. 176, 131 S.E. 587 (1926).

**As to certainty of amount to be paid and time of payment,** see *First Nat'l Bank v. Bynum*, 84 N.C. 25 (1881).

**As to necessity of payment in money,** see *Johnson v. Henderson*, 76 N.C. 227 (1877).

**Restriction as to Payment.**—A stipulation stamped on the face of a check, that it will positively not be paid to a certain company or its agents, is a valid restriction and binding on the holder. *Commercial Nat'l Bank v. First Nat'l Bank*, 118 N.C. 783, 24 S.E. 524 (1896).

**Instrument Written in Pencil.** — See *Gudger v. Fletcher*, 29 N.C. 372 (1847).

**Bill of Exchange.** — Where a draft drawn to the maker's order and, having been indorsed by another, is accepted at a bank, and then purchased in due course before maturity by an innocent purchaser for value, the bank may not resist payment upon the ground that the transaction was ultra vires, and not within the authority of its charter, authorizing it to accept bills, notes, commercial paper, etc., for it comes within the NIL definition of an inland bill of exchange. *Sherrill v. American Trust Co.*, 176 N.C. 591, 97 S.E. 471 (1918).

**A check** is an instrument by which a depositor seeks to withdraw funds from a bank. *Diemar & Kirk Co. v. Smart Styles, Inc.*, 261 N.C. 156, 134 S.E.2d 134 (1964).

A check is defined as a written order on a bank or banker, purporting to be drawn against a deposit of funds, for the payment at all events of a sum of money to a certain person therein named, or to him or his order, or to bearer, and payable on demand. *Woody v. First Nat'l Bank*, 194 N.C. 549, 140 S.E. 150 (1927).

A check is a contract within itself, and



it is equivalent to the drawer's promise to pay the payee or holder. *Diemar & Kirk Co. v. Smart Styles, Inc.*, 261 N.C. 156, 134 S.E.2d 134 (1964).

By the act of drawing and delivering a check to the payee, the drawer commits himself to pay the amount of the check in the event the drawee refuses payment upon presentment. *Diemar & Kirk Co. v. Smart Styles, Inc.*, 261 N.C. 156, 134 S.E.2d 134 (1964).

There is little difference between a check and a demand note, as a practical matter, in business transactions; both are acknowledgments of indebtedness and an unconditional promise to pay. *Diemar & Kirk Co. v. Smart Styles, Inc.*, 261 N.C. 156, 134 S.E.2d 134 (1964).

A check is an order to the bank on which it is drawn to pay the amount thereof and charge it to the drawer's account. In respect of a check, the bank on which it is drawn is the drawee, and when presented to the drawee the provisions of the NIL, as to the time allowed a drawee to accept a bill applied. *Branch Banking & Trust Co. v. Bank of Washington*, 255 N.C. 205, 120 S.E.2d 830 (1961).

**Certificate of Deposit.**—See *Johnson v. Henderson*, 76 N.C. 227 (1877).

**Bond.** — A bond is in form negotiable, and when indorsed for value and without notice before maturity it is to be regarded, so far as its negotiability is concerned and its liability to be governed by the commercial law applicable to promissory notes, as if it were a promissory note not under seal. *Miller v. Tharel*, 75 N.C. 148 (1876); *Spence v. Tabscott*, 93 N.C. 246 (1885). The principle was applied in *Lewis v. Long*, 102 N.C. 206, 9 S.E. 637 (1889), in which it was decided that an obligor on a bond could not, as against an indorsee for value, before maturity and without notice, set up the defense that he executed the same as a surety only. *Christian v. Parrott*, 114 N.C. 215, 19 S.E. 151 (1894).

Provisions that a bond should be pay-

able to bearer, or if registered to the registered holder only, and provisions for an extension of time, upon application of the maker, in the discretion of trustee in the deed of trust securing it, did not change its negotiable character. *Thomas v. De Moss*, 202 N.C. 646, 163 S.E. 759 (1932).

A municipal bond payable to bearer, and otherwise complying as to form with the provisions of the NIL, was a negotiable instrument, and as such when in the hands of a holder in due course was not subject to defenses which would otherwise ordinarily be available to the municipal corporation by which the bond was issued. *Bankers' Trust Co. v. Statesville*, 203 N.C. 399, 166 S.E. 169 (1932).

A bond indemnifying a bank from any loss which it might sustain by reason of its taking over the assets and discharging the liabilities of another bank, the bond being payable to the liquidating bank and not to its order, was not a negotiable instrument within the meaning of the NIL. *North Carolina Bank & Trust Co. v. Williams*, 201 N.C. 464, 160 S.E. 484 (1931).

**County Warrant.** — Although county warrants are transferable by indorsement and the indorsee or holder may sue upon them in his own name, they are not negotiable in the sense that the holder in due course was protected by the NIL. *Wright v. Kinney*, 123 N.C. 618, 31 S.E. 874 (1898).

**Due Bill.**—See *Purtel v. Morehead*, 19 N.C. 239 (1837).

**Unsigned Travelers' Check.** — A travelers' check not signed or countersigned by the purchaser or holder is not a negotiable instrument, since it is not an unconditional promise to pay to the order of a specified person or bearer, the promise to pay being conditioned upon the check being countersigned with the signature appearing at the top of the check. *Venable v. American Express Co.*, 217 N.C. 548, 8 S.E.2d 804 (1940).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 1, 5, 10, 126, 184 and 185, Uniform Negotiable Instruments Law.

**Changes:** Parts of original sections combined and reworded; new provision; original Section 10 omitted.

**Purposes of changes and new matter:** The changes are intended to bring together in one section related provisions and definitions formerly widely separated.

1. Under subsection (1) (b) any writing, to be a negotiable instrument within

this Article, must be payable in money. In a few states there are special statutes, enacted at an early date when currency was less sound and barter was prevalent, which make promises to pay in commodities negotiable. Even under these statutes commodity notes are now little used and have no general circulation. This Article makes no attempt to provide for such paper, as it is a matter of purely local concern. Even if retention of the old statutes is regarded in any state as important,

amendment of this section may not be necessary, since "within this Article" in subsection (1) leaves open the possibility that some writings may be made negotiable by other statutes or by judicial decision. The same is true as to any new type of paper which commercial practice may develop in the future.

2. While a writing cannot be made a negotiable instrument within this Article by contract or by conduct, nothing in this section is intended to mean that in a particular case a court may not arrive at a result similar to that of negotiability by finding that the obligor is estopped by his conduct from asserting a defense against a bona fide purchaser. Such an estoppel rests upon ordinary principles of the law of simple contract; it does not depend upon negotiability, and it does not make the writing negotiable for any other purpose. But a contract to build a house or to employ a workman, or equally a security agreement does not become a negotiable instrument by the mere insertion of a clause agreeing that it shall be one.

3. The words "no other promise, order, obligation or power" in subsection (1) (b) are an expansion of the first sentence of the original Section 5. Section 3—112 permits an instrument to carry certain limited obligations or powers in addition to the simple promise or order to pay money. Subsection (1) of this section is intended to say that it cannot carry others.

4. Any writing which meets the requirements of subsection (1) and is not excluded under Section 3—103 is a negotiable instrument, and all sections of this Article apply to it, even though it may contain additional language beyond that contemplated by this section. Such an instrument is a draft, a check, a certificate of deposit or a note as defined in subsection (2).

Traveler's checks in the usual form, for instance, are negotiable instruments under this Article when they have been completed by the identifying signature.

5. This Article omits the original Section 10, which provided that the instrument need not follow the language of the act if it "clearly indicates an intention to conform" to it. The provision has served no useful purpose, and it has been an encouragement to bad drafting and to liberality in holding questionable paper to be negotiable. The omission is not intended to mean that the instrument must follow the language of this section, or that one term may not be recognized as clearly the equivalent of another, as in the case of "I undertake" instead of "I promise," or "Pay to holder" instead of "Pay to bearer." It does mean that either the language of the section or a clear equivalent must be found, and that in doubtful cases the decision should be against negotiability.

6. Subsection (3) is intended to make clear the same policy expressed in Section 3—805.

#### Cross references:

Sections 3—105 through 3—112, 3—401, 3—402 and 3—403.

Point 1: Section 3—107.

Point 3: Section 3—112.

Point 4: Sections 3—103 and 3—805.

Point 6: Section 3—805.

#### Definitional cross references:

"Bank". Section 1—201.

"Bearer". Section 1—201.

"Definite time". Section 3—109.

"Money". Section 1—201.

"On demand". Section 3—108.

"Order". Section 3—102.

"Promise". Section 3—102.

"Signed". Section 1—201.

"Term". Section 1—201.

"Writing". Section 1—201.

### NORTH CAROLINA COMMENT

This section brings together in one place several related definitional provisions that were widely scattered under the NIL.

The definition of a "negotiable instrument within this article" is set forth in subsection (1) (a). This definition is substantially the same as the definition of a "negotiable instrument" under NIL 1 (GS 25-7). A full comprehension of the general definition can be obtained only by a further examination of the following sections which are subsequently discussed in more detail:

GS 25-3-105 on "unconditional promise or order";

GS 25-3-106 on "sum certain";

GS 25-3-109 on "in money";

GS 25-3-112 on additional promises, orders, obligations or powers which can be included without killing negotiability under article 3;

GS 25-3-108 on "on demand";

GS 25-3-109 on "at a definite time";

GS 25-3-110 on "to order";

GS 25-3-111 on "to bearer."

An examination of the above list together with the definition in subsection (1) (b) of GS 25-3-104 reveals that the full tests for determining whether a particular instrument is a negotiable instrument under article 3 can be determined only by reading GS 25-3-104 through 25-3-112 as a

unit. Also, GS 25-3-113 (seal), 25-3-114 (date, antedating, postdating), and 25-3-119 (other writings affecting instrument) in part deal with the problem of whether a particular instrument is a "negotiable instrument within this article."

*Note:* Both subsection (1) of GS 25-3-104 and the above discussion use the technical expression "a negotiable instrument within this article." As pointed out in Official Comment 1, this choice of language (i.e., "within this article") leaves open the possibility that some instruments may be made "negotiable" by other statutes or by court decision.

For example, article 8 (investment securities) and article 7 (documents of title) both give negotiable characteristics (e.g., ease of transfer, etc.) to the types of paper governed by them; and yet these instruments are not "negotiable instruments within this article."

Also, for example, court decisions at some future time may ascribe negotiable characteristics to certain paper that does not meet the technical definition of GS 25-3-104. In such a situation it would be proper to describe such paper as a "negotiable

instrument"; however, it would not be a "negotiable instrument within this article."

For purposes of discussion herein the term "negotiable instrument" used alone will be used to mean "negotiable instrument within this article." Much of the literature on article 3 uses such abbreviated terminology even though in a technical sense it may not be entirely accurate. Even the UCC itself harmlessly employs the simple term "negotiable instrument" when it apparently means "a negotiable instrument within this article." For example, GS 25-3-102 (1) (e) states: "'instrument' means a negotiable instrument."

*Additional Promises Clause:* Of special importance under subsection (1) (b) is the provision which states that any promise or order in addition to the basic promise or order to pay money will kill negotiability *unless* the additional promise or order is expressly approved by GS 25-3-112 or other sections in article 3. Thus, as will be noted in the North Carolina Comment to GS 25-3-112, the UCC takes an "exclusive" approach to the question of what additional matters may be included in an instrument without killing its negotiability.

**§ 25-3-105. When promise or order unconditional.**—(1) A promise or order otherwise unconditional is not made conditional by the fact that the instrument

- (a) is subject to implied or constructive conditions; or
- (b) states its consideration, whether performed or promised, or the transaction which gave rise to the instrument, or that the promise or order is made or the instrument matures in accordance with or "as per" such transaction; or
- (c) refers to or states that it arises out of a separate agreement or refers to a separate agreement for rights as to prepayment or acceleration; or
- (d) states that it is drawn under a letter of credit; or
- (e) states that it is secured, whether by mortgage, reservation of title or otherwise; or
- (f) indicates a particular account to be debited or any other fund or source from which reimbursement is expected; or
- (g) is limited to payment out of a particular fund or the proceeds of a particular source, if the instrument is issued by a government or governmental agency or unit; or

(h) is limited to payment out of the entire assets of a partnership, unincorporated association, trust or estate by or on behalf of which the instrument is issued.

(2) A promise or order is not unconditional if the instrument

- (a) states that it is subject to or governed by any other agreement; or
- (b) states that it is to be paid only out of a particular fund or source except as provided in this section. (1899, c. 733, s. 3; Rev., s. 2153; C. S., s. 2984; 1965, c. 700, s. 1.)

**Cross Reference.**—See note to § 25-3-104.

**Statement of Transaction.**—A negotiable instrument, setting out the transaction for which the instrument is given, cannot be set aside when a holder in due course takes without notice of the infirm-

ity or defect, where there is nothing in such contract to restrict negotiability in the instrument or to indicate fraud or an existent breach. *First Nat'l Bank v. Michael*, 96 N.C. 53, 1 S.E. 855 (1887); *Bank of Sampson v. Hatcher*, 151 N.C. 359, 66 S.E. 308 (1909).



## OFFICIAL COMMENT

Prior uniform statutory provision: Section 3, Uniform Negotiable Instruments Law.

Changes: Completely revised.

**Purposes of changes:** The section is intended to make it clear that, so far as negotiability is affected, the conditional or unconditional character of the promise or order is to be determined by what is expressed in the instrument itself; and to permit certain specific limitations upon the terms of payment.

1. Paragraph (a) of subsection (1) rejects the theory of decisions which have held that a recital in an instrument that it is given in return for an executory promise gives rise to an implied condition that the instrument is not to be paid if the promise is not performed, and that this condition destroys negotiability. Nothing in the section is intended to imply that language may not be fairly construed to mean what it says, but implications, whether of law or fact, are not to be considered in determining negotiability.

2. Paragraph (b) of subsection (1) is an amplification of Section 3(2) of the original act. The final clause is intended to resolve a conflict in the decisions over the effect of such language as "This note is given for payment as per contract for the purchase of goods of even date, maturity being in conformity with the terms of such contract." It adopts the general commercial understanding that such language is intended as a mere recital of the origin of the instrument and a reference to the transaction for information, but is not meant to condition payment according to the terms of any other agreement.

3. Paragraph (c) of subsection (1) likewise is intended to resolve a conflict, and to reject cases in which a reference to a separate agreement was held to mean that payment of the instrument must be limited in accordance with the terms of the agreement, and hence was conditioned by it. Such a reference normally is inserted for the purpose of making a record or giving information to anyone who may be interested, and in the absence of any express statement to that effect is not intended to limit the terms of payment. Inasmuch as rights as to prepayment or acceleration have to do with a "speed-up" in payment and since notes frequently refer to separate agreements for a statement of these rights, such reference does not destroy negotiability even though it has mild aspects of incorporation by reference. The

general reasoning with respect to subparagraph (c) also applies to a draft which on its face states that it is drawn under a letter of credit (subparagraph (d)). Paragraphs (c) and (d) therefore adopt the position that negotiability is not affected. If the reference goes further and provides that payment must be made according to the terms of the agreement, it falls under paragraph (a) of subsection (2).

4. Paragraph (e) of subsection (1) is intended to settle another conflict in the decisions, over the effect of "title security notes" and other instruments which recite the security given. It rejects cases which have held that the mere statement that the instrument is secured, by reservation of title or otherwise, carries the implied condition that payment is to be made only if the security agreement is fully performed. Again such a recital normally is included only for the purpose of making a record or giving information, and is not intended to condition payment in any way. The provision adopts the position of the great majority of the courts.

5. Paragraph (f) of subsection (1) is a rewording of Section 3(1) of the original Act.

6. Paragraph (g) of subsection (1) is new. It is intended to permit municipal corporations or other governments or governmental agencies to draw checks or to issue other short-term commercial paper in which payment is limited to a particular fund or to the proceeds of particular taxes or other sources of revenue. The provision will permit some municipal warrants to be negotiable if they are in proper form. Normally such warrants lack the words "order" or "bearer," or are marked "Not Negotiable," or are payable only in serial order, which makes them conditional.

7. Paragraph (h) of subsection (1) is new. It adopts the policy of decisions holding that an instrument issued by an unincorporated association is negotiable although its payment is expressly limited to the assets of the association, excluding the liability of individual members; and recognizing as negotiable an instrument issued by a trust estate without personal liability of the trustee. The policy is extended to a partnership and to any estate. The provision affects only the negotiability of the instrument, and is not intended to change the law of any state as to the liability of a partner, trustee, executor, administrator, or any other person on such an instrument.

8. Paragraph (a) of subsection (2) retains the generally accepted rule that

where an instrument contains such language as "subject to terms of contract between maker and payee of this date," its payment is conditioned according to the terms of the agreement and the instrument is not negotiable. The distinction is between a mere recital of the existence of the separate agreement or a reference to it for information, which under paragraph (c) of subsection (1) will not affect negotiability, and any language which, fairly construed, requires the holder to look to the other agreement for the terms of payment. The intent of the provision is that an instrument is not negotiable unless the holder can ascertain all of its essential terms from its face. In the specific instance of rights as to prepayment or acceleration, however, there may be a reference to a

separate agreement without destroying negotiability.

9. Paragraph (b) of subsection (2) restates the last sentence of Section 3 of the original Act. As noted above, exceptions are made by paragraphs (g) and (h) of subsection (1) in favor of instruments issued by governments or governmental agencies, or by a partnership, unincorporated association, trust or estate.

**Cross reference:**

Section 3—104.

**Definitional cross references:**

"Account". Section 4—104.

"Agreement". Section 1—201.

"Instrument". Section 3—102.

"Issue". Section 3—102.

"Order". Section 3—102.

"Promise". Section 3—102.

### NORTH CAROLINA COMMENT

The Official Comments reasonably explain that this completely revised section alters the previous statutory law of GS 25-9 to some extent. The effect of the new section on previous North Carolina decisions is as follows:

(1) *Commissioners of Cleveland County v. Bank of Gastonia*, 157 N.C. 191, 72 S.E. 996 (1911). This case was decided under NIL 3 (former GS 25-9) which provided that if an instrument was payable only from a particular fund, then the instrument was nonnegotiable. The case found that the bonds of a township in Cleveland County were negotiable even though a particular fund had been set up for their payment. The court found: "These bonds are the general and unrestricted obligation of that body corporate. They are not payable solely out of a particular fund, although a particular fund is provided for their payment."

Under subsection (1) (g) the instruments of governmental units will be negotiable even if they are to be paid only from a particular fund. Thus, under the new provisions of subsection (1) (b) the bonds in the *Cleveland County* case would be negotiable even if they had been limited to payment from a particular fund.

Also, since the instruments were "bonds" they would, under GS 25-8-102, be classified as "securities"; and, thus they would be governed by article 8 (investment pa-

per) rather than article 3 (commercial paper). In general, then, the liberalizing provisions of subsection (1) (g) will be limited to governmental instruments that are not investment securities.

(2) *Royster v. Hancock*, 235 N.C. 110, 69 S.E.2d 29 (1952). This case held that the language "as per our agreement" in a note does not keep the instrument from being negotiable. The decision would be codified by subsection (1) (a).

(3) *Branch Bank & Trust Co. v. Leggett*, 185 N.C. 65, 116 S.E. 1 (1923). *Held*: The fact that an instrument with an unconditional promise in its first sentence also contained a subsequent paragraph relating to a *conditional retention of title* in the seller of a peanut picker (for which the instrument had been given) which did not kill negotiability. The case was decided on two grounds: (1) The basic unconditional promise was not later conditioned by the additional provisions regarding the conditional sale aspects; (2) the additional provisions were approved by GS 25-11 (1) (NIL 5 (1)) which permitted a provision which "authorizes the sale of collateral securities in case the instrument is not paid at maturity." The second ground relating to the propriety of provisions authorizing the sale of security has been brought forward in GS 25-3-112 (1) (b).

**§ 25-3-106. Sum certain.**—(1) The sum payable is a sum certain even though it is to be paid

(a) with stated interest or by stated installments; or

(b) with stated different rates of interest before and after default or a specified date; or

(c) with a stated discount or addition if paid before or after the date fixed for payment; or

(d) with exchange or less exchange, whether at a fixed rate or at the current rate; or

(e) with costs of collection or an attorney's fee or both upon default.

(2) Nothing in this section shall validate any term which is otherwise illegal. (1899, c. 733, ss. 2, 6, 197; 1905, c. 327; Rev., ss. 2152, 2155, 2346; C. S., ss. 2983, 2987; 1965, c. 700, s. 1.)

**Editor's Note.**—In *First Nat'l Bank v. Bynum*, 84 N.C. 25 (1881), decided before the NIL was enacted, it was held that a provision for attorneys' fees and exchange made the note nonnegotiable because of uncertainty of the amount to be paid. This was changed by the adoption of the NIL, § 25-8.

By amendment to the NIL, § 25-8, a provision was inserted by the legislature of this State so that, in accordance with the uniform law, a stipulation for attorney's fees did not destroy the negotiability of the instrument, but the stipulation was not enforceable. See *North Carolina Comment* to this section. It was the evident policy of the legislature to prevent any stipulation permitting "collection fees," as being against public policy. See *Turner v. Boger*, 126 N.C. 300, 35 S.E. 592 (1900), and citations. An application of the operation of this provision will be found in *Security Fin. Co. v. Hendry*, 189 N.C. 549, 177 S.E. 629 (1925).

Since a provision for collection fees was invalid it did not affect the amount in suit in determining the jurisdiction of a

justice court. *Exchange Bank v. Apalachian Land & Lumber Co.*, 128 N.C. 193, 38 S.E. 813 (1901). And since attorney's fees were not collectible under the NIL, as amended, an agent with special authority to pay a note due out of fund held by him was limited to a payment of the principal sum, interests and costs that had accrued at the time of payment. *Hooper v. Merchants' Bank & Trust Co.*, 190 N.C. 423, 130 S.E. 49 (1925).

It will be noted, however, that this section of the UCC does not include such a provision as to the enforceability of stipulations as to collection or attorney's fees.

#### **Foreign Contract for Attorney's Fees.**—

The validity of a provision in a note for attorney's fees executed and payable in Georgia, must be determined by the laws of North Carolina. *Exchange Bank v. Apalachian Land & Lumber Co.*, 128 N.C. 193, 38 S.E. 813 (1901). And because of § 25-8 (repealed by the UCC), the courts of North Carolina would not enforce such a provision. *Security Fin. Co. v. Hendry*, 189 N.C. 549, 177 S.E. 629 (1925).

### **OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 2 and 6(5), Uniform Negotiable Instruments Law.

**Changes:** Reworded.

**Purposes of changes:** The new language is intended to clarify doubts arising under the original section as to interest, discounts or additions, exchange, costs and attorney's fees, and acceleration or extension.

1. The section rejects decisions which have denied negotiability to a note with a term providing for a discount for early payment on the ground that at the time of issue the amount payable was not certain. It is sufficient that at any time of payment the holder is able to determine the amount then payable from the instrument itself with any necessary computation. Thus a demand note bearing interest at six per cent is negotiable. A stated discount or addition for early or late payment does not affect the certainty of the sum so long as the computation can be made, nor do different rates of interest

before and after default or a specified date. The computation must be one which can be made from the instrument itself without reference to any outside source, and this section does not make negotiable a note payable with interest "at the current rate."

2. Paragraph (d) recognizes the occasional practice of making the instrument payable with exchange deducted rather than added.

3. In paragraph (e) "upon default" is substituted for the language of the original Section 2(5) in order to include any default in payment of interest or instalments.

4. The section contains no specific language relating to the effect of acceleration clauses on the certainty of the sum payable. Section 2(3) of the original act contained a saving clause for provisions accelerating principal on default in payment of an instalment or of interest, which led to doubt as to the effect of other accelerating provisions. This Article (Section 3—



109, Definite time) broadly validates acceleration clauses; it is not necessary to state the matter in this section as well. The disappearance of the language referred to in old Section 2(3) means merely that it was regarded as surplusage.

5. Most states have usury laws prohibiting excessive rates of interest. In some states there are statutes or rules of law invalidating a term providing for increased interest after maturity, or for costs and

attorney's fees. Subsection (2) is intended to make it clear that this section is concerned only with the effect of such terms upon negotiability, and is not meant to change the law of any state as to the validity of the term itself.

**Cross references:**

Section 3—104.

Point 4: Section 3—109.

**Definitional cross reference:**

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1) (a)* permits a negotiable instrument to contain provisions for interest and for installment payments. This is in accord with GS 25-8 (1) and (2).

*Subsection (1) (b)* permits different rates of interest before and after default. The clarifying purpose of subsections (1) (b) and (c) is stated in Official Comment 1.

No North Carolina case on the subject was found.

*Subsection (1) (e) and subsection (2)* require special attention. Subsection (1) (e) adopts the prior view of GS 25-8 (5) (NIL 2 (5)), which stated that the inclusion of a provision for the payment of "costs of collection or an attorney's fee in case payment is not made at maturity" does not kill negotiability. However, GS 25-8 (5) had amended NIL 2 (5) by stating further: "But a provision incorporated in the instrument to pay counsel fees for collection is not enforceable, but it does not affect the other terms of the instrument or the negotiability thereof."

By use of the additional language in GS 25-8 (5), North Carolina added a *procedural* provision to NIL 2 (5). In other jurisdictions the enforceability of the harmless attorney's fees clause in the instrument is determined by separate reference to the rules of procedure governing the allowance of attorney's fees pursuant to the contract of the parties.

The present situation in North Carolina on the allowance of attorney's fees appears to be this:

(1) Specific statutes allow attorney's fees as a part of costs in certain enumerated situations. See generally: GS 6-21, 6-21.1, 28-170.1, 50-16 and many other sections under "Fees" in the index to the North Carolina General Statutes. None of these specifically permit attorney's fees in an action on a negotiable instrument; and the general policy of North Carolina is not to allow counsel's fees in the absence of statutory provision.

(2) GS 25-8 (5) by its amendment to NIL 2 (5) specifically denied the collection of attorneys' fees even when voluntarily contracted for in a negotiable instrument.

(3) *Queen City Coach Co. v. Lumber-ton Coach Co.*, 229 N.C. 534, 50 S.E.2d 496 (1948), by dictum ("In the absence of express agreement" for attorney's fees such will not be allowed) implies that an advance contract for the payment of attorney's fees to a party forced to sue might be enforced. However, no clear-cut North Carolina decision was found on the enforceability of contracts for attorney's fees other than the several cases condemning the enforcement of such contracts as part of *negotiable instruments*. The few cases decided under the "no enforcement" provisions of GS 25-8 (5) firmly supported the policy of the statute on negotiable instruments.

For a short general discussion of attorney's fees as a part of costs, see 38 N.C.L. Rev. 156 (1960).

**§ 25-3-107. Money.**—(1) An instrument is payable in money if the medium of exchange in which it is payable is money at the time the instrument is made. An instrument payable in "currency" or "current funds" is payable in money.

(2) A promise or order to pay a sum stated in a foreign currency is for a sum certain in money and, unless a different medium of payment is specified in the instrument, may be satisfied by payment of that number of dollars which the stated foreign currency will purchase at the buying sight rate for that currency on the day on which the instrument is payable or, if payable on demand, on the day of demand. If such an instrument specifies a foreign currency as the medium of payment the instrument is payable in that currency. (1899, c. 733, s. 6; Rev., s. 2155; C. S., s. 2987; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 6(5), Uniform Negotiable Instruments Law.

**Changes:** Completely rewritten.

**Purposes of changes and new matter:** To make clear when an instrument is payable in money and to state rules applicable to instruments drawn payable in a foreign currency.

1. The term "money" is defined in Section 1—201 as "a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency". That definition rejects the narrow view of some early cases that "money" is limited to legal tender. Legal tender acts do no more than designate a particular kind of money which the obligee will be required to accept in discharge of an obligation. It rejects also the contention sometimes advanced that "money" includes any medium of exchange current and accepted in the particular community, whether it be gold dust, beaver pelts, or cigarettes in occupied Germany. Such unusual "currency" is necessarily of uncertain and fluctuating value, and an instrument intended to pass generally in commerce as negotiable may not be made payable therein.

The test adopted is that of the sanction of government, which recognizes the circulating medium as a part of the official currency of that government. In particular the provision adopts the position that an instrument expressing the amount to be paid in sterling, francs, lire or other recognized currency of a foreign government is negotiable even though payable in the United States.

2. The provision on "currency" or "current funds" accepts the view of the great majority of the decisions, that "currency" or "current funds" means that the instrument is payable in money.

3. Either the amount to be paid or the medium of payment may be expressed in terms of a particular kind of money. A draft passing between Toronto and Buffalo may, according to the desire and convenience of the parties, call for payment of 100 United States dollars or of 100 Canadian dollars; and it may require either sum to be paid in either currency. Under this section an instrument in any of these forms is negotiable, whether payable in Toronto or in Buffalo.

4. As stated in the preceding paragraph the intention of the parties in making an instrument payable in a foreign currency may be that the medium of payment shall be either dollars measured by the foreign currency or the foreign currency in which the instrument is drawn. Under subsection (2) the presumption is, unless the instrument otherwise specifies, that the obligation may be satisfied by payment in dollars in an amount determined by the buying sight rate for the foreign currency on the day the instrument becomes payable. Inasmuch as the buying sight rate will fluctuate from day to day, it might be argued that an instrument expressed in a foreign currency but actually payable in dollars is not for a "sum certain". Subsection (2) makes it clear that for the purposes of negotiability under this Article such an instrument, despite exchange fluctuations, is for a sum certain.

**Cross references:**

Section 3—104.

Point 1: Section 1—201.

Point 4: Section 4—212(6).

**Definitional cross references:**

"Instrument". Section 3—102.

"Money". Section 1—201.

"Order". Section 3—102.

"Promise". Section 3—102.

"Purchase". Section 1—201.

## NORTH CAROLINA COMMENT

The Official Comment adequately describes the relatively minor changes which make it clear when an instrument is payable in money. Rules regarding payment in foreign money are also stated in the section.

All North Carolina cases on "Medium of Payment" (Bills and Notes, Key Number 162) are pre-NIL decisions. For example, early cases held that notes payable in tobacco (2 N.C. 372) or lumber (3 N.C. 150) or "in bank stock or lawful money" (19 N.C. 513) are not negotiable. These decisions are affirmed by this section.

Levy v. Meir, 248 N.C. 328, 103 S.E.2d 288 (1958), happened to involve a note payable in "dinars," but the case did not discuss the foreign money question. The court apparently assumed that an action "to recover the dollar equivalent of 450 dinars" was proper.

Subsection (1) would change the decision of Johnson v. Henderson, 76 N.C. 227 (1877), which held that a certificate of deposit payable in "current funds" is not negotiable. Subsection (1) states: "An instrument payable in 'currency' or 'current funds' is payable in money."

**§ 25-3-108. Payable on demand.**—Instruments payable on demand include those payable at sight or on presentation and those in which no time for payment is stated. (1899, c. 733, s. 7; Rev., s. 2157; C. S., s. 2988; 1965, c. 700, s. 1.)

**Statute of Limitations.**—A promissory note, payable on demand, is due immediately, and the statute of limitations runs from the date. *Caldwell v. Rodman*, 50

N.C. 139 (1857). The same is true of a bond when no time is specified for payment of it. *Ervin v. Brook*, 111 N.C. 358, 16 S.E. 240 (1892).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 7, Uniform Negotiable Instruments Law.

**Changes:** Reworded, final sentence of original section omitted.

**Purposes of changes:** Except for the omission of the final sentence this section restates the substance of original Section 7. The final sentence dealt with the status of a person issuing, accepting or indorsing an instrument after maturity and provided that as to such a person the instrument was payable on demand. That language implied that the ordinary rules relating to demand instruments as to due course, holding, presentment, notice of dishonor and so on were applicable. This Article

abandons that concept which served no special purpose except to trap the unwary. Under Section 3—302 (Holder in due course) and in view of the deletion from this section of the final sentence of original Section 7 there is no longer the possibility that one taking time paper after maturity may acquire due course rights against a post-maturity indorser. Section 3—501(4), however, provides that the indorser after maturity is not entitled to presentment, notice of dishonor or protest.

**Cross references:**

Sections 3—104, 3—302 and 3—501(4).

**Definitional cross reference:**

"Instrument". Section 3—102.

#### NORTH CAROLINA COMMENT

The Official Comment adequately explains that this section makes no material change in prior law, except to drop the

ambiguous last sentence of NIL 7 (GS 25-13). The omitted sentence has caused no problem in North Carolina.

**§ 25-3-109. Definite time.**—(1) An instrument is payable at a definite time if by its terms it is payable

(a) on or before a stated date or at a fixed period after a stated date; or

(b) at a fixed period after sight; or

(c) at a definite time subject to any acceleration; or

(d) at a definite time subject to extension at the option of the holder, or to extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event.

(2) An instrument which by its terms is otherwise payable only upon an act or event uncertain as to time of occurrence is not payable at a definite time even though the act or event has occurred. (1899, c. 733, s. 4; Rev., s. 2156; C. S., s. 2985; 1923, c. 72; 1965, c. 700, s. 1.)

**Acceleration Clause Did Not Prevent Negotiability.** — Acceleration of the maturity of a note, or of notes in a series, as the result of the failure of the maker to pay interest, or to pay one of the notes of said series, when same became due, according to the tenor of the note or notes, by virtue of an agreement to that effect appearing on the face of the note, or notes, did not make the note, or notes of the

series, payable upon a contingency, and therefore nonnegotiable within the meaning of the NIL. *Newbern Banking & Trust Co. v. Duffy*, 153 N.C. 62, 68 S.E. 915 (1910); *Walter v. Kilpatrick*, 191 N.C. 458, 132 S.E. 148 (1926).

**Nor Did Agreement to Be Bound Notwithstanding Extension.**—See *First Nat'l Bank v. Johnston*, 169 N.C. 526, 86 S.E. 360 (1915).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 4 and 17(3), Uniform Negotiable Instruments Law.

**Changes:** Reworded; new provisions; rule of original Section 4(3) reversed.

**Purposes of changes and new matter:**



To remove uncertainties arising under the original section, and to eliminate commercially unacceptable instruments.

1. Subsection (2) reverses the rule of the original Section 4(3) as to instruments payable after events certain to happen but uncertain as to time. Almost the only use of such instruments has been in the anticipation of inheritance or future interests by borrowing on post-obituary notes. These have been much more common in England than in the United States. They are at best questionable paper, not acceptable in general commerce, with no good reason for according them free circulation as negotiable instruments. As in the case of the occasional note payable "one year after the war" or at a similar uncertain date, they are likely to be made under unusual circumstances suggesting good reason for preserving defenses of the maker. They are accordingly eliminated.

2. With this change "definite time" is substituted for "fixed or determinable future time." The time of payment is definite if it can be determined from the face of the instrument.

3. An undated instrument payable "thirty days after date" is not payable at a definite time, since the time of payment cannot be determined on its face. It is, however, an incomplete instrument within the provisions of Section 3-115 dealing with such instruments and may be completed by dating it. It is then payable at a definite time.

4. Paragraph (c) of subsection (1) resolves a conflict in the decisions on the negotiability of instruments containing acceleration clauses as to the meaning and effect of "on or before a fixed or determinable future time" in the original Section 4(2). (Instruments expressly stated to be payable "on or before" a given date are dealt with in subsection (1) (a).) So far as certainty of time of payment is concerned a note payable at a definite time but subject to acceleration is no less certain than a note payable on demand, whose negotiability never has been questioned. It is in fact more certain, since it at least states a definite time beyond which the instrument cannot run. Objections to the acceleration clause must be based rather on the possibility of abuse by the holder, which has nothing to do with negotiability and is not limited to

negotiable instruments. That problem is now covered by Section 1-208.

Subsection (1) (c) is intended to mean that the certainty of time of payment or the negotiability of the instrument is not affected by any acceleration clause, whether acceleration be at the option of the maker or the holder, or automatic upon the occurrence of some event, and whether it be conditional or unrestricted. If the acceleration term itself is uncertain it may fail on ordinary contract principles, but the instrument then remains negotiable and is payable at the definite time.

The effect of acceleration clauses upon a holder in due course is covered by the new definition of the holder in due course (Section 3-302) and by the section on notice to purchaser (subsection (3) of Section 3-304). If the purchaser is not aware of any acceleration, his delay in making presentment may be excused under the section dealing with excused presentment (subsection (1) of Section 3-511).

5. Paragraph (d) of subsection (1) is new. It adopts the generally accepted rule that a clause providing for extension at the option of the holder, even without a time limit, does not affect negotiability since the holder is given only a right which he would have without the clause. If the extension is to be at the option of the maker or acceptor or is to be automatic, a definite time limit must be stated or the time of payment remains uncertain and the instrument is not negotiable. Where such a limit is stated, the effect upon certainty of time of payment is the same as if the instrument were made payable at the ultimate date with a term providing for acceleration.

The construction and effect of extension clauses is covered by paragraph (f) of Section 3-118 on ambiguous terms and rules of construction, to which reference should be made.

#### Cross references:

Section 3-104.

Point 3: Section 3-115.

Point 4: Sections 1-208, 3-118(f), 3-304(3) and 3-511(1).

Point 5: Section 3-118(f)

#### Definitional cross references:

"Holder". Section 1-201.

"Instrument". Section 3-102.

"Term". Section 1-201.

### NORTH CAROLINA COMMENT

*Subsection (1) (c):* A troublesome problem under NIL 4 (GS 25-10) was whether a note payable at a time certain, but subject to an acceleration clause was payable

at a determinable future time as required by the NIL. Some of the cases involved acceleration clauses permitting a holder to accelerate at his will, and the courts

occasionally held that such acceleration clauses made the time uncertain, thus the instrument was nonnegotiable.

By this poor "nonnegotiable" reasoning the courts attempted to protect the maker of the instrument who had contracted for an acceleration clause that was harsh to him. Better reasoned decisions, however, took the view that the note was still negotiable, but that the harsh acceleration clause should not be enforced.

By amendment at the end of NIL 4 (GS 25-10) North Carolina permitted any acceleration clause: "But an instrument payable at a determinable future time is negotiable, even though it may mature or be declared due upon a contingency happening before such future time."

A similar provision is found in subsection (1) (c).

The above North Carolina amendment relating to acceleration clauses did not specify the effect of a clause that gave the holder a capricious option to accelerate; and there are no North Carolina cases on the matter.

**§ 25-3-110. Payable to order.**—(1) An instrument is payable to order when by its terms it is payable to the order or assigns of any person therein specified with reasonable certainty, or to him or his order, or when it is conspicuously designated on its face as "exchange" or the like and names a payee. It may be payable to the order of

- (a) the maker or drawer; or
- (b) the drawee; or
- (c) a payee who is not maker, drawer or drawee; or
- (d) two or more payees together or in the alternative; or
- (e) an estate, trust or fund, in which case it is payable to the order of the representative of such estate, trust or fund or his successors; or
- (f) an office, or an officer by his title as such in which case it is payable to the principal but the incumbent of the office or his successors may act as if he or they were the holder; or
- (g) a partnership or unincorporated association, in which case it is payable to the partnership or association and may be indorsed or transferred by any person thereto authorized.

(2) An instrument not payable to order is not made so payable by such words as "payable upon return of this instrument properly indorsed."

(3) An instrument made payable both to order and to bearer is payable to order unless the bearer words are handwritten or typewritten. (1899, c. 733, s. 8; Rev., s. 2158; C. S., s. 2989; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 8, Uniform Negotiable Instruments Law.

**Changes:** Reworded, new provisions.

**Purposes of changes and new matter:** The changes are intended to remove uncertainties arising under the original section.

1. Paragraph (d) of subsection (1) re-

places the capricious option problem is solved, however, by GS 25-1-208, which provides that clauses permitting a holder to accelerate "at will," etc., will be enforced only when he acts in "good faith." Thus, under the UCC the question of "negotiability" is separated from the independent question of "enforceability." GS 25-3-109 (c) and 25-1-208. See also North Carolina Comment on GS 25-1-208.

**Subsection (2):** As explained in the Official Comment 1, this section makes an important change by excluding from the operation of article 3 those instruments that are payable on the happening of a certain event the time of which is uncertain. For example, an instrument payable at the death of an individual (or at the end of a war, etc.) will not be a "negotiable instrument within this article." No North Carolina cases were found on the subject.

Official Comment 1 strongly states that instruments payable at such uncertain times as death or the end of a war are not fit to be ordinary commercial paper.

places the original subsections (4) and (5). It eliminates the word "jointly," which has carried a possible implication of a right of survivorship. Normally an instrument payable to "A and B" is intended to be payable to the two parties as tenants in common, and there is no survivorship in the absence of express language to that effect. The instrument may be payable to

"A or B," in which case it is payable to either A or B individually. It may even be made payable to "A and/or B," in which case it is payable either to A or to B singly, or to the two together. The negotiation, enforcement and discharge of the instrument in all such cases are covered by the section on instruments payable to two or more persons (Sec. 3—116).

2. Paragraph (e) of subsection (1) is intended to change the result of decisions which have held that an instrument payable to the order of the estate of a decedent was payable to bearer, on the ground that the name of the payee did not purport to be that of any person. The intent in such cases is obviously not to make the instrument payable to bearer, but to the order of the representative of the estate. The provision extends the same principle to an instrument payable to the order of "Tilden Trust," or "Community Fund". So long as the payee can be identified, it is not necessary that it be a legal entity; and in each case the instrument is treated as payable to the order of the appropriate representative or his successor.

3. Under paragraph (f) of subsection (1) an instrument may be made payable to the office itself ("Swedish Consulate") or to the officer by his title as such ("Treasurer of City Club"). In either case it runs to the incumbent of the office and his successors. The effect of instruments in such a form is covered by the section on instruments payable with words of description (Sec. 3—117).

4. Vestigial theories relating to the lack of "legal entity" of partnerships and various forms of unincorporated associations—such as labor unions and business trusts—make it the part of wisdom to specify that instruments made payable to such groups are order paper payable as designated and not bearer paper (subsection (1) (g)). As in the case of incorporated as-

sociations, any person having authority from the partnership or association to whose order the instrument is payable may indorse or otherwise deal with the instrument.

5. Subsection (2) is intended to change the result of cases holding that "payable upon return of this certificate properly indorsed" indicated an intention to make the instrument payable to any indorsee and so must be construed as the equivalent of "Pay to order." Ordinarily the purpose of such language is only to insure return of the instrument with indorsement in lieu of a receipt, and the word "order" is omitted with the intention that the instrument shall not be negotiable.

6. Subsection (3) is directed at occasional instruments reading "Pay to the order of John Doe or bearer." Such language usually is found only where the drawer has filled in the name of the payee on a printed form, without intending the ambiguity or noticing the word "bearer." Under such circumstances the name of the specified payee indicates an intent that the order words shall control. If the word "bearer" is handwritten or typewritten, there is sufficient indication of an intent that the instrument shall be payable to bearer. Instruments payable to "order of bearer" are covered not by this section but by the following Section 3—111.

#### Cross references:

Sections 3—104 and 3—111.

Point 1: Section 3—116.

Points 2, 3 and 4: Section 3—117.

#### Definitional cross references:

"Bearer". Section 1—201.

"Conspicuous". Section 1—201.

"Instrument". Section 3—102.

"Negotiation". Section 3—202.

"Person". Section 1—201.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

The Official Comments reasonably explain the purpose of this clarifying section. There are no important North Carolina

cases on the matter; and no important change in North Carolina law results from this section.

**§ 25-3-111. Payable to bearer.**—An instrument is payable to bearer when by its terms it is payable to

(a) bearer or the order of bearer; or

(b) a specified person or bearer; or

(c) "cash" or the order of "cash," or any other indication which does not purport to designate a specific payee. (1899, c. 733, s. 9; Rev., s. 2159; C. S., s. 2990; 1949, c. 953; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

Prior uniform statutory provision: Section 9, Uniform Negotiable Instruments Law.

Changes: Reworded; original subsections (3) and (5) omitted here but covered by Sections on impostors and signature in



name of payee (Section 3—405) and on special and blank indorsements (Section 3—204).

**Purposes of changes:** The rewording is intended to remove uncertainties.

1. Language such as “order of bearer” usually results when a printed form is used and the word “bearer” is filled in. Subsection (a) rejects the view that the instrument is payable to order, and adopts the position that “bearer” is the unusual word and should control. Compare Comment 6 to Section 3—110.

2. Paragraph (c) is reworded to remove any possible implication that “Pay to the order of —” makes the instrument payable to bearer. It is an incomplete order instrument, and falls under Section 3—115. Likewise “Pay Treasurer of X Corporation” does not mean pay bearer, even though there may be no such officer. Instruments payable to the order of an estate, trust, fund, partnership, unincorporated association or office are covered by

the preceding section. This subsection applies only to such language as “Pay Cash,” “Pay to the order of cash,” “Pay bills payable,” “Pay to the order of one keg of nails,” or other words which do not purport to designate any specific payee.

3. Under Section 40 of the original Act an instrument payable to bearer on its face remained bearer paper negotiable by delivery although subsequently specially indorsed. It should be noted that Section 3—204 on special indorsement reverses this rule and allows the special indorsement to control.

**Cross references:**

Sections 3—104, 3—204 and 3—405.

Point 2: Sections 3—110(1) (a) and (f) and 3—115.

Point 3: Section 3—204.

**Definitional cross references:**

“Bearer”. Section 1—201.

“Instrument”. Section 3—102.

“Person”. Section 1—201.

“Term”. Section 1—201.

**NORTH CAROLINA COMMENT**

As explained in the Official Comment, this section rewords NIL 9 (1), (2) and (4) (GS 25-15) to remove some prior uncertainties on the question of what paper is “bearer paper.”

The only important cases relating to bearer paper in North Carolina concern the “fictitious payee” or “payroll padding” problem. The “fictitious payee” problem

was formerly handled under NIL 9 (3) (GS 25-15 (3)), but under the UCC it is covered by GS 25-3-405 (imposters; signature in name of payee). See North Carolina Comment to GS 25-3-405.

See also GS 25-3-204, which now replaces NIL 9 (5) (GS 25-15 (5)) on blank indorsements as creating “bearer paper.”

**§ 25-3-112. Terms and omissions not affecting negotiability.—**(1) The negotiability of an instrument is not affected by

(a) the omission of a statement of any consideration or of the place where the instrument is drawn or payable; or

(b) a statement that collateral has been given to secure obligations either on the instrument or otherwise of an obligor on the instrument or that in case of default on those obligations the holder may realize on or dispose of the collateral; or

(c) a promise or power to maintain or protect collateral or to give additional collateral; or

(d) a term authorizing a confession of judgment on the instrument if it is not paid when due; or

(e) a term purporting to waive the benefit of any law intended for the advantage or protection of any obligor; or

(f) a term in a draft providing that the payee by indorsing or cashing it acknowledges full satisfaction of an obligation of the drawer; or

(g) a statement in a draft drawn in a set of parts (§ 25-3-801) to the effect that the order is effective only if no other part has been honored.

(2) Nothing in this section shall validate any term which is otherwise illegal. (1899, c. 733, ss. 5, 6, 197; 1905, c. 327; Rev., ss. 2154, 2155, 2346; C. S., ss. 2986, 2987; 1965, c. 700, s. 1.)

**Negotiability Not Affected by Recital as to Mortgage.**—The recital on the face of a note, to wit: “This is one of a series of notes secured by deed of trust or mort-

gage,” did not affect the negotiable character of the notes under the NIL. *Walter v. Kilpatrick*, 191 N.C. 458, 132 S.E. 148 (1926).

**Enforcement of Foreign Homestead Waiver.**—A provision in a note for the waiver of homestead exemption will not be forced by the courts of this State although

the note may have been executed by parties in another state. *Exchange Bank v. Apalachian Land & Lumber Co.*, 128 N.C. 193, 38 S.E. 813 (1901).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 5 and 6, Uniform Negotiable Instruments Law.

**Changes:** Reworded; new provisions; subsection (4) of original Section 5 omitted. Subsection (4) of the original Section 6 is now covered by Section 3—113, and subsection (5) by Section 3—107.

**Purposes of changes and new matter:** The changes are intended to remove uncertainties arising under the original sections. Subsection (4) of the original Section 5 is omitted because it has been important only in connection with bonds and other investment securities now covered by Article 8 of this Act. An option to require something to be done in lieu of payment of money is uncommon and not desirable in commercial paper.

This section permits the insertion of certain obligations and powers in addition to the simple promise or order to pay money. Under Section 3—104, dealing with form of negotiable instruments, the instrument may not contain any other promise, order obligation or power.

1. Paragraph (b) of subsection (1) permits a clause authorizing the sale or disposition of collateral given to secure obligations either on the instrument or otherwise of an obligor on the instrument upon any default in those obligations, including a default in payment of an installment or of interest. It is not limited, as was the original Section 5(1), to default at maturity. The reference to obligations of an obligor on the instrument is intended to recognize so-called cross collateral provisions that appear in collateral note forms used by banks and others throughout the United States and to permit the use of these provisions without destroying negotiability. Paragraph (c) is new. It permits a clause, apparently not within the original section, containing a promise or power to maintain or protect collateral or to give additional collateral, whether on demand or on some other condition. Such terms frequently are accompanied by a provision for acceleration if the collateral is not given, which is now permitted by the section on what constitutes a definite time. Section 1—208 should be consulted as to

the construction to be given such clauses under this Act.

2. As under the original Section 5(2), paragraph (d) is intended to mean that a confession of judgment may be authorized only if the instrument is not paid when due, and that otherwise negotiability is affected. The use of judgment notes is confined to two or three states, and in others the judgment clauses are made illegal or ineffective either by special statutes or by decision. Subsection (2) is intended to say that any such local rule remains unchanged, and that the clause itself may be invalid, although the negotiability of the instrument is not affected.

3. As in the case of the original Section 5(3), paragraph (e) applies not only to any waiver of the benefits of this Article, such as presentment, notice of dishonor or protest, but also to a waiver of the benefits of any other law such as a homestead exemption. Again subsection (2) is intended to mean that any rule which invalidates the waiver itself is not changed, and that while negotiability is not affected, a waiver of the statute of limitations contained in an instrument may be invalid.

This paragraph is to be read together with subsection (1) of Section 3—104 on form of negotiable instruments. A waiver cannot make the instrument negotiable within this Article where it does not comply with the requirements of that section.

4. Paragraph (f) is new. The effect of a clause of acknowledgment of satisfaction upon negotiability has been uncertain under the original section.

5. Paragraph (g) is intended to insure that a condition arising from the statement in question will not adversely affect negotiability.

#### Cross references:

Sections 3—104 and 3—105.

Point 1: Sections 1—208 and 3—109(1) (c).

Point 3: Section 3—104.

#### Definitional cross references:

"Draft". Section 3—104.

"Instrument". Section 3—102.

"On demand". Section 3—108.

"Promise". Section 3—102.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

As noted in the North Carolina comment to GS 25-3-104, under the provisions

of GS 25-3-104 (1) (b), an instrument to be a negotiable instrument within this

article must "contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this article . . . ."

GS 25-3-112 is the section which authorizes certain additional clauses. It also states what clauses or words normally found in negotiable instruments can be omitted without killing negotiability.

One important change relates to the rule of NIL 5 (4) (GS 25-11 (4)) which permits the holder to be given an election to require that something be done in lieu of payment of money. Under GS 25-3-104 and 25-3-112, such option in the holder would place the instrument beyond the scope of article 3. Such an instrument, however, might be ascribed the same characteristics as a negotiable instrument by future case decision.

The various subsections of GS 25-3-112 are briefly summarized as follows:

*Subsection (1) (a):* No substantive change in North Carolina law.

*Subsection (1) (b):* It appears that this subsection makes no substantive change in North Carolina law (especially in light of a North Carolina amendment to NIL 4 which added GS 25-10 (4), dealing with clauses relating to collateral).

*Subsection (1) (c):* A North Carolina amendment to NIL 4 (GS 25-10 (4)) would seem to have impliedly recognized the new rule of this subsection; thus *no substantive change*.

*Special note:* New York, California, and Virginia have added to subsection (1) (c) the following: "... to furnish financial information or to do or refrain from doing any other act for the protection of the obligation expressed in the instrument not involving the payment of money on account of the indebtedness evidenced by the instrument; or."

This modification was rejected by the Permanent Editorial Board in 1962 for the reason that "it would not only move substantially away from the 'courier without luggage' principle, but, in addition, could produce substantial confusion and litigation." Report No. 1 of the Permanent Editorial Board for the Uniform Commercial Code 73 (1963).

*Subsection (1) (d):* This clause permits the inclusion of a clause permitting confession of a judgment on the instrument if it is *not paid when due*. Under subsection (2), the enforceability of such clause would be determined by the ordinary procedural law of the various states.

By modification to NIL 5 (GS 25-11) North Carolina specifically stated: "But nothing in this section shall authorize the enforcement of an authorization to confess judgment . . . ."

On its face the above modification seems to say that the mere fact that a "confession" clause is not harmful to negotiability does not per se mean that it is enforceable; and one must look to ordinary procedural law to answer the enforceability question. (GS 1-247 to 1-249 cover confession of judgment.) In another sense, however, the amendment in GS 25-11 could be construed as a positive procedural rule forbidding the enforceability of confession clauses.

To avoid possible confusion in the future, it is suggested that North Carolina *not* modify GS 25-3-112 by adding a statement on the nonenforceability of confession of judgment clauses. This is a procedural matter which should be determined by procedural law (GS 1-247 to 1-249). Also subsection (2) recognizes that the enforceability of confession and other clauses must be determined by procedural law or by other statutes or cases. Subsection (2) states: "Nothing in this section shall validate any term which is otherwise illegal."

Parenthetically, it appears that a confession of a judgment authorization would not be enforceable under GS 1-247 to 1-249. However, if such clauses (whether in negotiable instruments or other contracts) should be made enforceable at some future time, the change could be accomplished by amendment to the procedural statutes only; and no amendment to GS 25-3-112 would be necessary.

*Case:* Monarch Refrigerating Co. v. Farmers Peanut Co., 74 F.2d 790 (4th Cir. 1935), held that the North Carolina modification to former GS 25-11 and GS 1-248 and 1-249 on confession of judgment are merely procedural sections.

*Subsection (1) (e):* This subsection permits the inclusion of clauses waiving homestead or other benefits of law for the advantage of the obligor. As in the case of confession of judgment, the provision of subsection (2) makes the enforceability of a homestead waiver clause depend on other State law.

The North Carolina law regarding contractual waivers of homestead is at present somewhat uncertain. The decided cases (Homestead, Key Numbers 154 to 181) do not clearly cover the enforceability of a waiver clause in an ordinary contract. The decisions either involve:



(1) Case where all interested parties (husband, wife and children) have not joined in an advance waiver in an ordinary contract.

(2) Cases where waiver is made after judgment.

(3) Cases where homestead was waived by deed of trust or other security device.

(4) Case where the advance waiver agreement was contained in a "negotiable instrument."

Perhaps the strongest language forbidding enforcement of an advance waiver in a negotiable instrument is found in dictum of *Howell v. Robertson*, 197 N.C. 572, 150 S.E. 32 (1929) which stated: "It may be noted that the waiver of homestead in the manner set forth in the above note is contrary to the law of this jurisdiction and also the allowance of attorneys' fees."

No authority is cited for this dictum, and it is uncertain whether: (1) The court concluded that this is to be the policy of North Carolina on any advance waiver; or (2) whether the no advance waiver rule is based on a strained construction of the last sentence of GS 25-11. That is, the court might have construed the last sentence of GS 25-11 as stating (1) a positive rule of nonenforceability of

advance waivers of homestead in negotiable instruments, rather than (2) as redundantly stating that the NIL 5 (GS 25-11) took no positive position on enforceability of advance waivers. Both NIL 5 and GS 25-3-112 (2) more clearly take the "no positive position view" and leave the question of enforceability to be determined by reference to other procedural or substantive law of the particular state.

*Subsection (1) (f):* This new section permits inclusion of a clause providing that a payee by indorsing or cashing a draft acknowledges full satisfaction of an obligation of the drawer. The effect of such clause on *negotiability* was previously uncertain. The new section does not take a position as to the substantive or procedural effect of acknowledgments of full satisfaction of an obligation.

*Subsection (1) (g):* Official Comment 5 adequately explains this.

*Subsection (2):* As explained in the prior North Carolina Comments to subsections (1) (d) and (e), this subsection states that the legality or enforceability of the several approved clauses is to be determined by reference to other State law. Thus, GS 25-3-112 is left simply as a section dealing with the problem of "negotiability."

§ 25-3-113. **Seal.**—An instrument otherwise negotiable is within this article even though it is under a seal. (1899, c. 733, s. 6; Rev., s. 2155; C. S., s. 2987; 1965, c. 700, s. 1.)

**Seal Does Not Affect Negotiability.**—The fact that an instrument is under seal does not affect the negotiability. First *Nat'l Bank v. Michael*, 96 N.C. 53, 1 S.E. 855 (1887). See *Pate v. Brown*, 85 N.C. 166 (1881).

**And Consideration Is Conclusively Pre-**

**sumed Therefrom.**—The lack of consideration cannot benefit a maker of a bond under seal because the law conclusively presumes that it was made upon good and sufficient consideration. *Angier v. Howard*, 94 N.C. 27 (1886); *Wester v. Bailey*, 118 N.C. 193, 24 S.E. 9 (1896).

#### OFFICIAL COMMENT

Prior uniform statutory provision. Section 6(4), Uniform Negotiable Instruments Law.

**Changes:** Reworded.

**Purposes of changes.** The revised wording is intended to change the result of decisions holding that while a seal does not affect the negotiability of an instrument it may affect it in other respects falling within the statute, such as the conclusiveness of consideration. The section is intended to place sealed instruments on the same footing as any other instruments so far as all sections of this Article are concerned. It does not affect any other stat-

utes or rules of law relating to sealed instruments except insofar as, in the case of negotiable instruments, they are inconsistent with this Article. Thus a sealed instrument which is within this Article may still be subject to a longer statute of limitations than negotiable instruments not under seal, or to such local rules of procedure as that it may be enforced by an action of special assumpsit.

**Cross reference:**

Section 3—104.

**Definitional cross reference:**

"Instrument". Section 3—102.

#### NORTH CAROLINA COMMENT

One problem resolved by this section involves the question whether the donor of a sealed negotiable instrument can plead the defense of "want of consider-

ation" when sued by the donee. There is no North Carolina case exactly on this point, but there is much dictum to the effect that a seal imports a consideration.

The purpose of GS 25-3-113 is to make all negotiable instruments alike, seal or no seal, as far as defenses are concerned; and "*want* and failure of consideration" are defenses against a non-HDC under GS 25-3-306 (c). Thus, under GS 25-3-113 a donor would have a defense against his donee in a suit on a sealed negotiable instrument, even though he might not have such defense in a suit on a nonnegotiable instrument.

The statute of limitations on a sealed

negotiable instrument will continue to be ten years for suits against the principal obligor just as under prior North Carolina law. GS 1-47 (2). Note that the ten-year period applies only to an action against the *principal* to the sealed instrument. The three-year period applies to the indorser of a sealed instrument even though his indorsement is under a separate seal. *Howard v. White*, 215 N.C. 130, 1 S.E.2d 356 (1939); *Pickett v. Rigsbee*, 252 N.C. 200, 113 S.E.2d 323 (1960). These cases appear to make a seal valueless against an indorser or surety as far as an extended period of limitations is concerned.

**§ 25-3-114. Date, antedating, postdating.**—(1) The negotiability of an instrument is not affected by the fact that it is undated, antedated or postdated.

(2) Where an instrument is antedated or postdated the time when it is payable is determined by the stated date if the instrument is payable on demand or at a fixed period after date.

(3) Where the instrument or any signature thereon is dated, the date is presumed to be correct. (1899, c. 733, ss. 6, 11, 12, 17; Rev., ss. 1952, 2155, 2161, 2162, 2341; C. S., ss. 2987, 2992, 2993, 2998; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

Prior uniform statutory provision: Sections 6(1), 11, 12 and 17(3), Uniform Negotiable Instruments Law.

Changes: Reworded; new provision; parts of original Section 12 omitted.

Purposes of changes and new matter: The rewording is intended to remove uncertainties arising under the original sections.

1. The reference to an "illegal or fraudulent purpose" in the original Section 12 is omitted as inaccurate and misleading. Any fraud or illegality connected with the date of an instrument does not affect its negotiability, but is merely a defense under Sections 3-306 and 3-307 to the same extent as any other fraud or illegality. The provision in the same section as to acquisition of title upon delivery is also omitted, as obvious and unnecessary.

2. Subsection (2) is new. An undated instrument payable "thirty days after date" is uncertain as to time of payment, and does not fall within Section 3-109(1) (a) on definite time. It is, however, an incomplete instrument, and the date may be inserted as provided in the section dealing

with such instruments (Section 3-115). When the instrument has been dated, this subsection follows decisions under the original Act in providing that the time of payment is to be determined from the stated date, even though the instrument is antedated or postdated. An antedated instrument may thus be due before it is issued. As to the liability of indorsers in such a case, see Section 3-501(4), on indorsement after maturity.

3. Subsection (3) extends the original Section 11 to any signature on an instrument. As to the meaning of "presumed," see section 1-201.

#### Cross references:

Point 1: Sections 3-306 and 3-307.

Point 2: Sections 3-109(1) (a), 3-115 and 3-501(4).

Point 3: Section 1-201.

#### Definitional cross references:

"Instrument". Section 3-102.

"Issue". Section 3-102.

"On demand". Section 3-108.

"Presumed". Section 1-201.

"Signature". Section 3-401.

**§ 25-3-115. Incomplete instruments.**—(1) When a paper whose contents at the time of signing show that it is intended to become an instrument is signed while still incomplete in any necessary respect it cannot be enforced until completed, but when it is completed in accordance with authority given it is effective as completed.

(2) If the completion is unauthorized the rules as to material alteration apply (§ 25-3-407), even though the paper was not delivered by the maker or drawer; but

the burden of establishing that any completion is unauthorized is on the party so asserting. (1899, c. 733, ss. 13 to 15; Rev., ss. 2163 to 2165; C. S., ss. 2994 to 2996; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 13, 14 and 15, Uniform Negotiable Instruments Law.

**Changes:** Condensed and reworded; original Section 13 and parts of Section 14 omitted; rule of Section 15 reversed.

**Purposes of changes:**

1. The original sections were lengthy and confusing. Section 13 is eliminated because it has suggested some uncertain distinction between undated instruments and those incomplete in other respects, and has carried the inference that only a holder may fill in the date. An instrument lacking in an essential date is merely one kind of incomplete instrument, to be treated like any other. The third sentence of Section 14, providing that the instrument must be filled up strictly in accordance with the authority given and within a reasonable time, is eliminated as entirely superfluous, since any authority must always be exercised in accordance with its limitations, and expires within a reasonable time unless a time limit is fixed.

2. The language "signed while still incomplete in any necessary respect" in subsection (1) is substituted for "wanting in any material particular" in the original Section 14, in order to make it entirely clear that a complete writing which lacks an essential element of an instrument and contains no blanks or spaces or anything else to indicate that what is missing is to be supplied, does not fall within the section. "Necessary" means necessary to a complete instrument. It will always include the promise or order, the designation of the payee, and the amount payable. It may include the time of payment where a blank is left for that time to be filled in; but where it is clear that no time is intended to be stated the instrument is complete, and is payable on demand under Section 3—108. It does not include the date of issue, which under Section 3—114(1) is not essential, unless the instrument is made payable at a fixed period after that date.

3. This section omits the second sentence of the original Section 14, providing that "a signature on a blank paper delivered by the person making the signature in order that the paper may be converted into a negotiable instrument operates as a prima facie authority to fill it up as such for any amount." This had

utility only in connection with the ancient practice of signing blank paper to be filled in later as an acceptance, at a time when communications were slow and difficult. The practice has been obsolete for nearly a century. It affords obvious opportunity for fraud, and should not be encouraged by express sanction in the statute. The omission is not intended, however, to mean that any person may not be authorized to write in an instrument over a signature either before or after delivery.

4. Subsection (2) states the rule generally recognized by the courts, that any unauthorized completion is an alteration of the instrument which stands on the same footing as any other alteration. Reference is therefore made to Section 3—407 where the effect of alteration is stated. Subsection (3) of that section provides that a subsequent holder in due course may in all cases enforce the instrument as completed, and replaces the final sentence of the original Section 14.

5. The language "even though the paper was not delivered" reverses the rule of the original Section 15, which provides that where an incomplete instrument has not been delivered it will not, if completed, be a valid contract in the hands of any holder as against any person whose signature was placed thereon before delivery. Since under this Article (Sections 3—305 and 3—407) neither non-delivery nor unauthorized completion is a defense against a holder in due course, it has always been illogical that the two together should invalidate the instrument in his hands. A holder in due course sees and takes the same paper, whether it was complete when stolen or completed afterward by the thief, and in each case he relies in good faith on the maker's signature. The loss should fall upon the party whose conduct in signing blank paper has made the fraud possible, rather than upon the innocent purchaser. The result is consistent with the theory of decisions holding the drawer of a check stolen and afterwards filled in to be estopped from setting up the non-delivery against an innocent party.

A similar provision protecting a depository bank which pays an item in good faith is contained in Section 4—401. The policy of that section should apply in favor of drawees other than banks.

6. The language on burden of establishing unauthorized completion is substituted



for the "prima facie authority" of the original Section 14. It follows the generally accepted rule that the full burden of proof by a preponderance of the evidence is upon the party attacking the completed instrument. "Burden of establishing" is defined in Section 1--201.

**Cross references:**

Point 2: Sections 3--108 and 3--114(1).

Point 4: Section 3--407.

Point 5: Sections 3--305(2), 3--407(3) and 4--401.

Point 6: Section 1--201.

**Definitional cross references:**

"Alteration". Section 3--407.

"Burden of establishing". Section 1--201.

"Delivery". Section 1--201.

"Instrument". Section 3--102.

"Party". Section 1--201.

"Signed". Section 1--201.

### NORTH CAROLINA COMMENT

This section makes some changes in prior law.

One change is a reversal of the rule of NIL 15 (former GS 25-21) which provided that an *incomplete* undelivered instrument could not be enforced even by an HDC. Under GS 25-3-115 (2) an HDC can enforce an instrument even though there has been no technical delivery by the maker or drawer.

Basically, the problem of *unauthorized completions* (whether of delivered or un-

delivered paper) is covered by GS 25-3-407 on material alteration.

*Case:* Phillips v. Hensley, 175 N.C. 23, 94 S.E. 673 (1918), held that an instrument may be enforced as completed when a maker issues a note blank as to amount and trusts another to complete it and the other completes it for an amount in excess of the amount authorized. Under the UCC this unauthorized completion case would be covered by GS 25-3-407 on material alteration.

**§ 25-3-116. Instruments payable to two or more persons.**—An instrument payable to the order of two or more persons

(a) if in the alternative is payable to any one of them and may be negotiated, discharged or enforced by any of them who has possession of it;

(b) if not in the alternative is payable to all of them and may be negotiated, discharged or enforced only by all of them. (1899, c. 733, s. 41; Rev., s. 2190; C. S., s. 3022; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 41, Uniform Negotiable Instruments Law.

**Changes:** Revised in wording and substance.

**Purposes of changes:** The changes are intended to make clear the distinction between an instrument payable to "A or B" and one payable to "A and B." The first names either A or B as payee, so that either of them who is in possession becomes a holder as that term is defined in Section 1--201 and may negotiate, enforce or discharge the instrument. The second is payable only to A and B together, and as provided in the original section both must indorse in order to negotiate the instru-

ment, although one may of course be authorized to sign for the other. Likewise both must join in any action to enforce the instrument, and the rights of one are not discharged without his consent by the act of the other.

If the instrument is payable to "A and/or B," it is payable in the alternative to A, or to B, or to A and B together, and it may be negotiated, enforced or discharged accordingly.

**Cross reference:**

Section 1--201.

**Definitional cross references:**

"Instrument". Section 3--102.

"Person". Section 1--201.

### NORTH CAROLINA COMMENT

The Official Comments adequately describe the purpose of this section. No real change in substance is made.

The rules of Virginia-Carolina Joint Stock Land Bank v. First & Citizens Nat'l Bank, 197 N.C. 526, 150 S.E. 34 (1929), and Dawson v. National Bank of Greenville, 197 N.C. 499, 150 S.E. 38 (1929), are not changed by this section. Both of these cases held

that one of two or more payees may not alone properly collect from a drawee bank in the absence of authority of the one to act for the others; and a drawee bank that pays only one payee is liable for the wrongful payment either (1) to the drawer (*Virginia-Carolina* case) or (2) to the other payees (*Dawson* case) if the bank has accepted or certified the check.

GS 25-47 (NIL 41) contained a special reference to partners as being able to sign on behalf of all partners. However, GS 25-3-116 is silent on the matter of who is

authorized to sign for another. Thus, whether there was an authorization must be determined by reference to other law (agency, partnership, etc.).

**§ 25-3-117. Instruments payable with words of description.**—An instrument made payable to a named person with the addition of words describing him

(a) as agent or officer of a specified person is payable to his principal but the agent or officer may act as if he were the holder ;

(b) as any other fiduciary for a specified person or purpose is payable to the payee and may be negotiated, discharged or enforced by him ;

(c) in any other manner is payable to the payee unconditionally and the additional words are without effect on subsequent parties. (1899, c. 733, s. 42 ; Rev., s. 2191 ; C. S., s. 3023 ; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision.** Section 42, Uniform Negotiable Instruments Law.

**Changes:** Revised and extended.

**Purposes of changes:**

1. Subsection (a) extends the policy of the original Section 42, which covered only cashiers and fiscal officers of banks and corporations, to any case where a payee is named with words describing him as agent or officer of another named person. The intent is to include all such descriptions as "John Doe, Treasurer of Town of Framingham," "John Doe, President Home Telephone Co.," "John Doe, Secretary of City Club," or "John Doe, agent of Richard Roe." In all such cases it is commercial understanding that the description is not added for mere identification but for the purpose of making the instrument payable to the principal, and that the agent or officer is named as payee only for convenience in enabling him to cash the check.

2. Subsection (b) covers such descriptions as "John Doe, Trustee of Smithers Trust," "John Doe, Administrator of the Estate of Richard Roe," or "John Doe, Executor under Will of Richard Roe." In such cases the instrument is payable to the individual named, and he may negotiate it, enforce it or discharge it, but he remains subject to any liability for breach of his obligation as a fiduciary. Any subsequent holder of the instrument is put

on notice of the fiduciary position, and under the section on notice to purchaser (Section 3—304) is not a holder in due course if he takes with notice that John Doe has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit, or otherwise in breach of duty.

3. Any other words of description, such as "John Doe, 1121 Main Street," "John Doe, Attorney" or "Jane Doe, unmarried widow," are to be treated as mere identification, and not in any respect as a condition of payment. The same is true of any description of the payee as "Treasurer," "President," "Agent," "Trustee," "Executor," or "Administrator," which does not name the principal or beneficiary. In all such cases the person named may negotiate, enforce or discharge the instrument if he is otherwise identified, even though he does not meet the description. Any subsequent party dealing with the instrument may disregard the description and treat the paper as payable unconditionally to the individual, and is fully protected in the absence of independent notice of other facts sufficient to affect his position.

**Cross reference:**

Point 2: Section 3—304(2).

**Definitional cross references:**

"Holder". Section 1—201.

"Instrument". Section 3—102.

"Party". Section 1—201.

"Person". Section 1—201.

#### NORTH CAROLINA COMMENT

The Official Comments adequately describe the purpose of this section, and there have been no North Carolina decisions under the prior law, GS 25-48.

Subsections (a) and (b) would permit an agent or fiduciary to enforce an instrument in his own name, and this may be in conflict with the North Carolina Real Party

in Interest Statute. See North Carolina Comment to GS 25-3-301 for discussion of which statute should control a suit by nonowners.

Subsections (b) and (c) use the term "payee" in describing the rights of parties named in an instrument together with words of description. The term "payee" is

not specifically defined in either the NIL or the UCC; however, it is traditionally used to mean only the person to whom the instrument is originally payable. This technical meaning is obviously continued in the UCC. See GS 25-3-302 (2). There-

fore, in a technical sense the application of subsections (b) and (c) is limited to "payee" even though it is probable that the same rules should apply to any named holder, whether he be the "payee" or "indorsee."

**§ 25-3-118. Ambiguous terms and rules of construction.**—The following rules apply to every instrument:

(a) Where there is doubt whether the instrument is a draft or a note the holder may treat it as either. A draft drawn on the drawer is effective as a note.

(b) Handwritten terms control typewritten and printed terms, and typewritten control printed.

(c) Words control figures except that if the words are ambiguous figures control.

(d) Unless otherwise specified a provision for interest means interest at the judgment rate at the place of payment from the date of the instrument, or if it is undated from the date of issue.

(e) Unless the instrument otherwise specifies two or more persons who sign as maker, acceptor or drawer or indorser and as a part of the same transaction are jointly and severally liable even though the instrument contains such words as "I promise to pay."

(f) Unless otherwise specified consent to extension authorizes a single extension for not longer than the original period. A consent to extension, expressed in the instrument, is binding on secondary parties and accommodation makers. A holder may not exercise his option to extend an instrument over the objection of a maker or acceptor or other party who in accordance with § 25-3-604 tenders full payment when the instrument is due. (1899, c. 733, ss. 17, 68; Rev., ss. 1952, 2217, 2341; C. S., ss. 2998, 3049; 1965, c. 700, s. 1.)

**Note without interest.**—A note given for a specified amount "without interest" will be construed to bear interest after

maturity. *Dowd v. North Carolina R.R.*, 70 N.C. 468 (1874).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 17 and 68, Uniform Negotiable Instruments Law.

**Changes:** Reworded; new provisions; original subsections (3) and (6) of Section 17 omitted. The original Section 17 (3) is covered, so far as the question can arise, by Sections 3—109(1) (a) and 3—114 of this Article. The original Section 17(6) is now covered by Section 3—402.

**Purposes of changes and new matter:**

1. The purpose of this section is to protect holders and to encourage the free circulation of negotiable paper by stating rules of law which will preclude a resort to parol evidence for any purpose except reformation of the instrument. Except as to such reformation, these rules cannot be varied by any proof that any party intended the contrary.

2. Subsection (a): The language of the original Section 17(5) is changed to make it clear that the provision is not limited to ambiguities of phrasing, but extends to any case where the form of the instrument leaves its character as a draft or a note in doubt.

3. Subsection (b): The original Section 17(4) is revised to cover typewriting because of its frequent use in instruments, particularly in promissory notes.

4. Subsection (c): The rewording of the original Section 17(1) is intended to make it clear that figures control only where the words are ambiguous and the figures are not.

5. Subsection (d): The revision of the original Section 17(2) is intended to make it clear that where the instrument provides for payment "with interest" without specifying the rate, the judgment rate of interest of the place of payment is to be taken as intended.

6. Subsection (e): This subsection combines and revises the original Section 17(7) and the last sentence of the original Section 68. The rule applies to any two or more persons who sign in the same capacity, whether as makers, drawers, acceptors or indorsers. It applies only where such parties sign as a part of the same transaction; successive indorsers are, of course, liable severally but not jointly.

7. Subsection (f): This provision is new.



It has reference to such clauses as "The makers and indorsers of this note consent that it may be extended without notice to them." Such terms usually are inserted to obtain the consent of the indorsers and any accommodation maker to extension which might otherwise discharge them under Section 3—606 dealing with impairment of recourse or collateral. An extension in accord with these terms binds secondary parties. The holder may not force an extension on a maker or acceptor who makes due tender; the holder is not free to refuse payment and keep interest running on a good note or other instrument by extending it over the objection of a maker or acceptor or other party who in accordance with Section 3—604 tenders full payment when the instrument is due. Where consent to extension has been

given, the subsection provides that unless otherwise specified the consent is to be construed as authorizing only one extension for not longer than the original period of the note.

**Cross references:**

Sections 3—109, 3—114, 3—402 and 3—606.

Point 7: Sections 3—604 and 3—606.

**Definitional cross references:**

"Draft". Section 3—104.

"Holder". Section 1—201.

"Instrument". Section 3—102.

"Issue". Section 3—102.

"Note". Section 3—104.

"Person". Section 1—201.

"Promise". Section 3—102.

"Signed". Section 1—201.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

The Official Comments adequately explain this section, and there are no North Carolina cases on subsections (a), (b) and (c).

*Subsection (d):* This subsection on ambiguous terms regarding interest must be read in conjunction with GS 25-3-122 (4) on interest. See North Carolina Comment to GS 25-3-122 (4).

*Subsection (e):* This clarifying section is not intended to affect the rules governing:

(1) Contribution between parties jointly and severally liable.

(2) The order of liability of parties

signing in different capacities or at different times. See North Carolina Comment to GS 25-3-414 (contract of indorser; order of liability).

*Subsection (f):* The most important part of this subsection deals with the effect on indorsers and accommodation makers of their consent to an extension of time. Under this new provision a holder may not exercise his option to extend an instrument over the objection of a party who in accordance with GS 25-3-604 tenders full payment when the instrument is due.

**§ 25-3-119. Other writings affecting instrument.**—(1) As between the obligor and his immediate obligee or any transferee the terms of an instrument may be modified or affected by any other written agreement executed as a part of the same transaction, except that a holder in due course is not affected by any limitation of his rights arising out of the separate written agreement if he had no notice of the limitation when he took the instrument.

(2) A separate agreement does not affect the negotiability of an instrument. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** This section is new. It is intended to resolve conflicts as to the effect of a separate writing upon a negotiable instrument.

1. This Article does not attempt to state general rules as to when an instrument may be varied or affected by parol evidence, except to the extent indicated by the comment to the preceding section. This section is limited to the effect of a separate written agreement executed as a part of the same transaction. The separate writing is most commonly an agreement creating or providing for a security

interest such as a mortgage, chattel mortgage, conditional sale or pledge. It may, however, be any type of contract, including an agreement that upon certain conditions the instrument shall be discharged or is not to be paid, or even an agreement that it is a sham and not to be enforced at all. Nothing in this section is intended to validate any such agreement which is fraudulent or void as against public policy, as in the case of a note given to deceive a bank examiner.

2. Other parties, such as an accommodation indorser, are not affected by the separate writing unless they were also parties

to it as a part of the transaction by which they became bound on the instrument.

3. The section applies to negotiable instruments the ordinary rule that writings executed as a part of the same transaction are to be read together as a single agreement. As between the immediate parties a negotiable instrument is merely a contract, and is no exception to the principle that the courts will look to the entire contract in writing. Accordingly a note may be affected by an acceleration clause, a clause providing for discharge under certain conditions, or any other relevant term in the separate writing. "May be modified or affected" does not mean that the separate agreement must necessarily be given effect. There is still room for construction of the writing as not intended to affect the instrument at all, or as intended to affect it only for a limited purpose such as foreclosure or other realization of collateral. If there is outright contradiction between the two, as where the note is for \$1,000 but the accompanying mortgage recites that it is for \$2,000, the note may be held to stand on its own feet and not to be affected by the contradiction.

4. Under this Article a purchaser of the instrument may become a holder in due course although he takes it with knowledge that it was accompanied by a separate agreement, if he has no notice of any defense or claim arising from the terms of the agreement. If any limitation in the separate writing in itself amounts to a defense or claim, as in the case of an agreement that the note is a sham and cannot be enforced, a purchaser with notice of it cannot be a holder in due course. The section also covers limitations which do not

in themselves give notice of any present defense or claim, such as conditions providing that under certain conditions the note shall be extended for one year. A purchaser with notice of such limitations may be a holder in due course, but he takes the instrument subject to the limitation. If he is without such notice, he is not affected by such a limiting clause in the separate writing.

5. Subsection (2) rejects decisions which have carried the rule that contemporaneous writings must be read together to the length of holding that a clause in a mortgage affecting a note destroyed the negotiability of the note. The negotiability of an instrument is always to be determined by what appears on the face of the instrument alone, and if it is negotiable in itself a purchaser without notice of a separate writing is in no way affected by it. If the instrument itself states that it is subject to or governed by any other agreement, it is not negotiable under this Article; but if it merely refers to a separate agreement or states that it arises out of such an agreement, it is negotiable.

#### Cross references:

Point 1: Section 3—119.

Point 4: Section 3—304(4) (b).

Point 5: Section 3—105(2) (a) and (1) (c).

#### Definitional cross references:

"Agreement". Section 1—201.

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Notice". Section 1—201.

"Rights". Section 1—201.

"Term". Section 1—201.

"Written" and "writing". Section 1—201.

### NORTH CAROLINA COMMENT

This section permits collateral written agreements to modify the terms of a negotiable instrument. The section does not purport to cover what parol evidence may be introduced to modify the instrument. This approach probably does not affect *Aden v. Doub*, 146 N.C. 10, 59 S.E. 162 (1907), which held that a collateral agreement could be used to show that a note was given on a condition.

Hopefully, the odd rule of *Brown v. Osteen*, 197 N.C. 305, 148 S.E. 434 (1929), may be changed by this section. The *Brown* case held that notes containing no acceleration clause could not be recovered on before their stated maturity even though a contemporaneous mortgage securing the notes clearly stated: "A failure to pay any

part of the interest, or any note or any part thereof, when due, shall mature all the indebtedness secured by the mortgage."

Compare *Meadows Co. v. Bryan*, 195 N.C. 398, 142 S.E. 487 (1928), on beginning of period of limitations.

As noted in Official Comment 3, if the provision of the collateral agreement relates only to acceleration for *time of sale of security* and does not state that the basic obligation in the notes is accelerated, then the only acceleration will be of the sale of security. In the *Brown* case, however, the contemporaneous agreement in the mortgage also clearly covered acceleration of the notes; and the agreement could be given effect under this new section.

**§ 25-3-120. Instruments “payable through” bank.** — An instrument which states that it is “payable through” a bank or the like designates that bank as a collecting bank to make presentment but does not of itself authorize the bank to pay the instrument. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** Insurance, dividend or payroll checks, and occasionally other types of instruments, are sometimes made payable “through” a particular bank. This section states the commercial understanding as to the effect of such language. The bank is not named as drawee, and it is not ordered or even authorized to pay the instrument out of the drawer’s account or any other funds of the drawer in its hands. Neither

is it required to take the instrument for collection in the absence of special agreement to that effect. It is merely designated as a collecting bank through which presentment is properly made to the drawee.

**Definitional cross references:**

“Bank”. Section 1—201.

“Collecting bank”. Section 4—105.

“Instrument”. Section 3—102.

“Presentment”. Section 3—504.

#### NORTH CAROLINA COMMENT

The Official Comment adequately describes the purpose of this new section, and

there are no known prior North Carolina statutes or cases on the matter.

**§ 25-3-121. Instruments payable at bank.**—A note or acceptance which states that it is payable at a bank is not of itself an order or authorization to the bank to pay it. (1899, c. 733, s. 87; Rev., s. 2237; C. S., s. 3069; 1965, c. 700, s. 1.)

**Editor’s Note.**—This section adopts the “Southern-Western” alternative discussed

in the Official and North Carolina Comments to this section.

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 87, Uniform Negotiable Instruments Law.

**Changes:** Alternative sections offered.

**Purposes of changes:** The original Section 87 has been amended so extensively that no uniformity has been achieved; and in many parts of the country it has been consistently disregarded in practice.

The original section represents the commercial and banking practice of New York and the surrounding states, according to which a note or acceptance made payable at a bank is treated as the equivalent of a draft drawn on the bank. The bank is not only authorized but ordered to make payment out of the account of the maker or acceptor when the instrument falls due, and it is expected to do so without consulting him. In the western and southern states a contrary understanding prevails. The note or acceptance payable at a bank is treated as merely designating a place of payment, as if the instrument were made payable at the office of an attorney. The bank’s only function is to notify the maker or acceptor that the instrument has been presented and to ask for his instructions; and in the absence of specific instructions

it is not regarded as required or even authorized to pay. Notwithstanding the original section western and southern banks have consistently followed the practice of asking for instructions and treating a direction not to pay as a revocation, equivalent to a direction to stop payment.

Both practices are well established, and the division is along geographical lines. A change in either practice might lead to undesirable consequences for holders, banks or depositors. The instruments involved are chiefly promissory notes, which infrequently cross state lines. There is no great need for uniformity. This section therefore offers alternative provisions, the first of which states the New York commercial understanding, and the second that of the south and west.

**Cross reference:**

Section 3—502.

**Definitional cross references:**

“Acceptance”. Section 3—410.

“Account”. Section 4—104.

“Bank”. Section 1—201.

“Draft”. Section 3—104.

“Instrument”. Section 3—102.

“Note”. Section 3—104.

“Order”. Section 3—102.



## NORTH CAROLINA COMMENT

GS 25-94 (NIL, 87) stated that an instrument "payable at a bank is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon." There were two views in the United States as to the meaning of this section:

(1) The "Northeastern" view construed the section as written and treated the bank as under an order to pay even though the instrument is a mere note (payable at the maker's bank).

(2) The "Southern-Western" view construed NIL, 87 to mean that the bank's only function is to notify the maker or acceptor that the instrument has been presented and to ask for his instructions.

The North Carolina view was not certain. There was, however, some strong dictum to the effect that a note payable at a bank should be treated as an order to pay (as was stated in GS 25-94). See *Dry v. Reynolds*, 205 N.C. 571, 172 S.E. 351 (1934); *Peasley-Gaulbert Co. v. Dixon*, 172 N.C. 411, 90 S.E. 421 (1916); *Branch Banking & Trust Co. v. Bank of Washington*, 255 N.C. 205, 120 S.E.2d 830 (1961). However, there appears to be no case that had squarely decided the issue.

It is believed that many bankers in North Carolina do not consider a note or draft that is merely payable at a bank as being the equivalent of an order to the bank to pay in the absence of separate agreement (actual or implied). In any event, the way is open for North Carolina to take a firm position on the matter.

The UCC presents a choice of two alternatives:

(1) Alternative "A" adopts the "Northeastern view" that the instrument is an order.

(2) Alternative "B" adopts the "Southern-Western view" that the instrument is not per se an order or an authorization.

Virginia has proposed and adopted yet a third alternative which reads: "A note or acceptance which states that it is payable at a bank is not of itself an order to the bank to pay it, but the bank may consider it an authorization to pay."

The reasons for adopting Alternative "B" are:

(1) The majority of other states have adopted this view.

(2) Instruments that are merely payable at a bank are better governed by specific instructions to the bank on particular items or on items of a particular class. For example, the average individual who picks up a blank note form from a bank with the printed statement "Payable at X Bank" probably does not believe that such note payable to another individual is the equivalent of an order to the named bank to pay the instrument when it comes due. However, he can instruct that a specific item be paid.

Also, for example, if the individual or company that uses such blank forms does wish to have the instruments paid by his bank as a matter of course, he can so instruct the bank.

For instruments for which there is no standing instruction, the bank can contact its customer for instructions as to whether a specific item is to be paid from funds of the customer.

In the absence of specific or implied instructions to the bank to pay, the instrument should not be paid from funds of the maker or acceptor merely because the instrument is payable at the bank.

**§ 25-3-122. Accrual of cause of action; interest.**—(1) A cause of action against a maker or an acceptor accrues

(a) in the case of a time instrument on the day after maturity;

(b) in the case of a demand instrument upon its date or, if no date is stated, on the date of issue.

(2) A cause of action against the obligor of a demand or time certificate of deposit accrues upon demand, but demand on a time certificate may not be made until on or after the date of maturity.

(3) A cause of action against a drawer of a draft or an indorser of any instrument accrues upon demand following dishonor of the instrument. Notice of dishonor is a demand.

(4) Unless an instrument provides otherwise, interest runs at the rate provided by law for a judgment

(a) in the case of a maker, acceptor or other primary obligor of a demand instrument, from the date of demand;

(b) in all other cases from the date of accrual of the cause of action. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

Prior uniform statutory provision: None.

## Purpose:

1. This section is new. It follows the generally accepted rule that action may be brought on a demand note immediately upon issue, without demand, since presentment is not required to charge the maker under the original Act or under this Article. An exception is made in the case of certificates of deposit for the reason that banking custom and expectation is that demand will be made before any liability is incurred by the bank, and the additional reason that such certificates are issued with the understanding that they will be held for a considerable length of time, which in many instances exceeds the period of the statute of limitations. As to makers and acceptors of time instruments generally, the cause of action accrues on the day after maturity. As to drawers of drafts (including checks) and all indorsers, the cause of action accrues, in conformity with their underlying contract on the instrument (Sections 3—413 and 3—414), only upon demand made, typically in the form of a notice of dishonor, after the instrument has been presented to and dishonored by the person designated on the instrument to pay it.

2. Closely related to the accrual of a cause of action is the question of when interest begins to run where the instrument is blank on the point. A term in the instrument providing for interest controls. (See Section 3—118(d) for the construction of a term which provides for interest but does not specify the rate or the time from which it runs.) In the absence of such a term and

except in the case of a maker, acceptor or other primary obligor of a demand instrument subsection (4) states the rule that interest at the judgment rate runs from the date the cause of action accrues. In the case of a primary obligor of a demand instrument, interest runs from the date of demand although the cause of action (subsection (1) (a)) accrues on the stated date of the instrument or on issue. There has been a conflict in the decisions as to when "legal" interest begins to run on a demand note. Some courts have taken the view that, since the note is due when issued without demand, it should follow that interest runs from the same date. On the other hand it is clear that there is no default until after demand by the holder and thus no reason for the imposition of the penalty on the maker. Subsection (4), therefore, adopts the position of the majority of the courts that on a demand note interest runs only from demand. This same rule is applied to acceptors and other primary obligors on a demand instrument.

## Cross references:

Point 1: Sections 3—501, 3—413 and 3—414.

Point 2: Section 3—118(d).

## Definitional cross references:

"Action". Section 1—201.

"Certificate of deposit". Section 3—102.

"Dishonor". Section 3—507.

"Draft". Section 3—104.

"Instrument". Section 3—102.

"Note". Section 3—104.

"Notice of dishonor". Section 3—508.

"On demand". Section 3—108.

## NORTH CAROLINA COMMENT

Subsections (1), (2) and (3), phrased in terms of "accrual," are intended to state the time at which the period of limitations begins to run in favor of various parties. The rules of subsections (1) (maker and acceptor) and (2) (obligor of a certificate of deposit) are reasonable. But, see subsection (3) below.

*Subsection (3):* The rule of this subsection may cause some unintended results. It states that: "A cause of action against a drawer of a draft or an indorser of any instrument *accrues upon demand* following dishonor of the instrument. Notice of dishonor is a demand." (Emphasis added.)

A possible unintended result of this language is seen by reference to other sections:

(1) GS 25-3-501 states that timely *presentment* and *notice of dishonor* are nec-

essary to charge secondary parties *unless* presentment and notice of dishonor are excused under GS 25-3-511.

(2) GS 25-3-503 (e) states that in order to charge a secondary party presentment for acceptance or payment must be made "within a reasonable time after such party becomes liable" on the instrument.

(3) GS 25-3-502 discharges any indorser when notice of dishonor is delayed without excuse.

By applying the above general rules and by *disregarding* the "excused" provisions of GS 25-3-511, a secondary party, after the maturity of an instrument, would either:

(a) Be relieved from liability due to the delay of the holder in making presentment and notice of dishonor; or

(b) if these conditions precedent to secon-

dary liability had been met, the period of limitations would have begun to run in favor of the secondary party under GS 25-3-112 (3) from the "demand" on him. A problem arises, however, when GS 25-3-511 comes into play.

(4) GS 25-3-511 (2) (a). This section excuses timely presentment and notice of dishonor when such have been expressly waived. Typically, printed drafts and notes contain such waiver so as to hold secondary parties liable even though a timely presentment and notice of dishonor are not given. Thus, a holder can legally continue the liability of a secondary party for a long period of time after dishonor of the instrument but before he gives notice of this dishonor.

It is suggested that the continued liability of a secondary party who has waived timely presentment and notice of dishonor should not exceed the period of limitations of three years from the time the instrument is due to be paid or accepted. However, subsection (3) now states that "a cause of action against a drawer of a draft or an indorser of any instrument accrues upon demand following dishonor." Thus, it appears that a holder has within his power

the determination of when the period of limitations will begin in favor of a secondary party who has waived timely presentment and notice of dishonor.

*Note:* It is possible that GS 25-3-507 (2) on a holder's "immediate right of recourse against the drawers and indorsers" upon dishonor could be construed to mean that the statute of limitations provisions of GS 25-3-122 (3) will begin even before a "demand following dishonor." However, the Official Comments do not mention this possibility.

*Subsection (4):* This new section on interest must be read in conjunction with GS 25-3-118 (d) in order to get a full coverage on the rules of interest on a negotiable instrument:

(a) GS 25-3-118 (d) is a construction section regarding an instrument which provides for interest, but states no rate or time.

(b) GS 25-3-122 (4) is a procedural section regarding interest on non-interest-bearing obligations. It affirms the rule of *Dowd v. North Carolina R.R.*, 70 N.C. 468 (1874), holding that a "non-interest" note will bear interest after maturity.

## PART 2.

### TRANSFER AND NEGOTIATION.

**§ 25-3-201. Transfer; right to indorsement.**—(1) Transfer of an instrument vests in the transferee such rights as the transferor has therein, except that a transferee who has himself been a party to any fraud or illegality affecting the instrument or who as a prior holder had notice of a defense or claim against it cannot improve his position by taking from a later holder in due course.

(2) A transfer of a security interest in an instrument vests the foregoing rights in the transferee to the extent of the interest transferred.

(3) Unless otherwise agreed any transfer for value of an instrument not then payable to bearer gives the transferee the specifically enforceable right to have the unqualified indorsement of the transferor. Negotiation takes effect only when the indorsement is made and until that time there is no presumption that the transferee is the owner. (1899, c. 733, ss. 27, 49, 58; Rev., ss. 2175, 2198, 2207; C. S., ss. 3007, 3030, 3039; 1965, c. 700, s. 1.)

**Indorsement is not the only mode by which an interest in notes may be assigned** in view of this section. *Dozier v. Leary*, 196 N.C. 12, 144 S.E. 368 (1928), applying this rule in a case where a husband transferred his interest in a note executed by him and his wife by a registered paper writing, which was held competent evidence in an action by the transferee for one half the proceeds of the note.

**But Subsequent Holder of Order Paper Is Not Holder in Due Course without Indorsement.**—Where a note is payable to order and not to bearer, the indorsement

of the payee is necessary to transfer the legal title; and where this is not done, a subsequent holder is not one in due course, though the instrument may have been indorsed to him for value by an intermediate holder. *Tyson v. Joyner*, 139 N.C. 69, 51 S.E. 803 (1905); *Steinhilper v. Basnight*, 153 N.C. 293, 69 S.E. 220 (1910); *Elgin City Banking Co. v. McEachern*, 163 N.C. 333, 79 S.E. 680 (1913). See North Carolina Comment to this section. See also *Foxman v. Hanes*, 218 N.C. 722, 12 S.E.2d 258 (1941).

One making a note payable to her own



order and delivering it to another without indorsement does not make the holder a holder in due course. *Planters Bank v. Yelverton*, 185 N.C. 314, 117 S.E. 299 (1923).

A purchaser of a negotiable instrument for value before maturity, but without indorsement, becomes the holder of the equitable title only, and takes subject to any defense the maker may have against the original payee. *Bresee v. Crumpton*, 121 N.C. 122, 28 S.E. 351 (1897); *Steinhilper v. Basnight*, 153 N.C. 293, 69 S.E. 220 (1910); *Planters Bank v. Yelverton*, 185 N.C. 314, 117 S.E. 299 (1923); *Whitman v. York*, 192 N.C. 87, 133 S.E. 427 (1926); *Foxman v. Hanes*, 218 N.C. 722, 12 S.E.2d 258 (1941).

The introduction of a note in evidence without indorsement raises the presumption of equitable ownership and assignment, and without proof of indorsement the holder is not one in due course. *Woods v. Finley*, 153 N.C. 497, 69 S.E. 502 (1910).

Where the plaintiff at the trial presented the draft sued on, with the name of the drawee stamped on the back and testified that the draft had been discounted to him

by the drawee before maturity for value and without notice, he is only the equitable owner, in the absence of proof that the instrument had been indorsed, and he holds it subject to any valid defense open to the maker, and it was error to exclude evidence tending to show fraud. *Mayers v. McRimmon*, 140 N.C. 640, 53 S.E. 447 (1906).

**And Indorsement Must Be Obtained before Note Is Past Due.**—Where a note is assigned as collateral security for another note, and the assignee holds the collateral note without procuring the indorsement of the assignor until after the collateral note is past due, the assignee is not a holder in due course of the collateral note, and takes same subject to all equities existing in favor of the maker of the collateral note as against the payee who assigned same. *Hare v. Hare*, 208 N.C. 442, 181 S.E. 246 (1935).

**Payee Cannot Obtain Bona Fide Holder's Rights in Note Invalid between Payee and Maker.**—If a note is invalid as between the maker and the payee, the payee cannot himself, by purchase from a bona fide holder, become successor to his rights. *Ray v. Livingston*, 204 N.C. 1, 167 S.E. 496 (1933).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 27, 49 and 58, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworted; new provisions.

**Purposes of changes and new matter:** To make it clear that:

1. The section applies to any transfer, whether by a holder or not. Any person who transfers an instrument transfers whatever rights he has in it. The transferee acquires those rights even though they do not amount to "title."

2. The transfer of rights is not limited to transfers for value. An instrument may be transferred as a gift, and the donee acquires whatever rights the donor had.

3. A holder in due course may transfer his rights as such. The "shelter" provision of the last sentence of the original Section 58 is merely one illustration of the rule that anyone may transfer what he has. Its policy is to assure the holder in due course a free market for the paper, and that policy is continued in this section. The provision is not intended and should not be used to permit any holder who has himself been a party to any fraud or illegality affecting the instrument, or who has received notice of any defense or claim against it, to wash the paper clean by passing it into the hands of a holder in

due course and then repurchasing it. The operation of the provision is illustrated by the following examples:

(a) A induces M by fraud to make an instrument payable to A, A negotiates it to B, who takes as a holder in due course. After the instrument is overdue B gives it to C, who has notice of the fraud. C succeeds to B's rights as a holder in due course, cutting off the defense.

(b) A induces M by fraud to make an instrument payable to A, A negotiates it to B, who takes as a holder in due course. A then repurchases the instrument from B. A does not succeed to B's rights as a holder in due course, and remains subject to the defense of fraud.

(c) A induces M by fraud to make an instrument payable to A, A negotiates it to B, who takes with notice of the fraud. B negotiates it to C, a holder in due course, and then repurchases the instrument from C. B does not succeed to C's rights as a holder in due course, and remains subject to the defense of fraud.

(d) The same facts as (c), except that B had no notice of the fraud when he first acquired the instrument, but learned of it while he was a holder and with such knowledge negotiated to C. B does not succeed to C's rights as a holder in due

course, and his position is not improved by the negotiation and repurchase.

4. The rights of a transferee with respect to collateral for the instrument are determined by Article 9 (Secured Transactions).

5. Subsection (2) restates original Section 27 and is intended to make it clear that a transfer of a limited interest in the instrument passes the rights of the transferor to the extent of the interest given. Thus a transferee for security acquires all such rights subject of course to the provisions of Article 9 (Secured Transactions).

6. Subsection (3) applies only to the transfer for value of an instrument payable to order or specially indorsed. It has no application to a gift, or to an instrument payable or indorsed to bearer or indorsed in blank. The transferee acquires, in the absence of any agreement to the contrary, the right to have the indorsement of the transferor. This right is now made enforceable by an action for specific performance. Unless otherwise agreed, it is a right to the general indorsement of the transferor with full liability as indorser, rather than to an indorsement without recourse. The question commonly arises where the purchaser has paid in advance and the indorsement is omitted fraudulently or through oversight; a transferor who is willing to indorse only without recourse or unwilling to indorse at all should make his intentions clear. The agreement for the transferee to take less than an unqualified indorsement need not be an express one, and the understanding may be implied from conduct, from past practice, or from the circumstances of the transaction.

#### NORTH CAROLINA COMMENT

A lengthy Official Comment reasonably explains this section which will help to clarify prior North Carolina statutes and cases.

While subsection (1) gives a donee whatever rights his donor had, under subsection (3) only a transferee can for value compel his transferor to give an unqualified indorsement.

In the past several North Carolina cases inaccurately held that under GS 25-55 (NIL 49) the legal title to a negotiable instrument did not pass when it was order paper transferred without indorsement. See *Tyson v. Joyner*, 139 N.C. 69, 51 S.E. 803 (1905); *Mayers v. McRimmon*, 140 N.C. 640, 53 S.E. 447 (1906).

These decisions were correct, however, in stating that even an innocent purchaser for value could not be an HDC in his own

7. Subsection (3) follows the second sentence of the original Section 49 in providing that there is no effective negotiation until the indorsement is made. Until that time the purchaser does not become a holder, and if he receives earlier notice of defense against or claim to the instrument he does not qualify as a holder in due course under Section 3—302(1) (c).

8. The final clause of subsection (3), which is new, is intended to make it clear that the transferee without indorsement of an order instrument is not a holder and so is not aided by the presumption that he is entitled to recover on the instrument provided in Section 3—307(2). The terms of the obligation do not run to him, and he must account for his possession of the unindorsed paper by proving the transaction through which he acquired it. Proof of a transfer to him by a holder is proof that he has acquired the rights of a holder and that he is entitled to the presumption.

#### Cross references:

Sections 3—202 and 3—416.

Point 5: Article 9.

Point 7: Section 3—302(1) (c).

Point 8: Section 3—307(2)

#### Definitional cross references:

"Bearer". Section 1—201.

"Holder". Section 1—201.

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Negotiation". Section 3—202.

"Notice". Section 1—201.

"Party". Section 1—201.

"Presumption". Section 1—201.

"Rights". Section 1—201.

"Security interest". Section 1—201.

right unless he first becomes a "holder" by negotiation (i.e., obtaining the proper indorsements on order paper); and this rule is continued under GS 25-3-302 (1) ("a holder in due course is a holder who . . .").

*The Derivative HDC Problem:* As noted in Official Comment 3, an HDC may transfer his rights as such. Thus some transferees, whether they be holders or not, will have the rights of an HDC even though they do not themselves meet the tests for HDC status under GS 25-3-302.

Official Comment 3 illustrates the special rules about when "a party to any fraud or illegality affecting the instrument or who was a prior holder had notice of or defense claim against it cannot improve his position by taking from a later holder in due course." As shown by the illustrations, the

actual decision of *Pierce v. Carlton*, 184 N.C. 175, 114 S.E. 13 (1922), would be adopted by this section. However, the dictum of the case (criticised in 1 N.C.L. Rev. 187) would be rejected by this section.

*Wellons v. Warren*, 203 N.C. 178, 165

S.E. 545 (1932), is affirmed by the UCC. The case held that a purchaser from HDC gets rights of HDC unless purchaser is himself a party to fraud or illegality affecting the notes, although he knows of the equities at the time he purchases.

**§ 25-3-202. Negotiation.**—(1) Negotiation is the transfer of an instrument in such form that the transferee becomes a holder. If the instrument is payable to order it is negotiated by delivery with any necessary indorsement; if payable to bearer it is negotiated by delivery.

(2) An indorsement must be written by or on behalf of the holder and on the instrument or on a paper so firmly affixed thereto as to become a part thereof.

(3) An indorsement is effective for negotiation only when it conveys the entire instrument or any unpaid residue. If it purports to be of less it operates only as a partial assignment.

(4) Words of assignment, condition, waiver, guaranty, limitation or disclaimer of liability and the like accompanying an indorsement do not affect its character as an indorsement. (1899, c. 733, ss. 30-32; Rev., ss. 2178, 2179, 2181; C. S., ss. 3010, 3011, 3013; 1965, c. 700, s. 1.)

**What Constitutes Delivery.**—To constitute delivery of a negotiable note there must be a parting with the possession and with power and control over it by the maker or indorser for the benefit of the payee or indorsee. To constitute delivery the note must be put out of possession of the indorser. *Sinclair v. Travis*, 231 N.C. 345, 57 S.E.2d 394 (1950).

A letter written by the payee in transmitting to the maker a note for execution, declaring that the payee had and does will the indebtedness thereby evidenced to his grandchildren, the children of the maker, so that in case of his previous death the notes would be the property of his grandchildren, was insufficient to constitute a gift *inter vivos* to his grandchildren, there being nothing in the language to show present donative intent, and there being neither actual nor constructive delivery of the notes to them. *Sinclair v. Travis*, 231 N.C. 345, 57 S.E.2d 394 (1950).

**Delivery May Be Actual or Constructive.**—Where a negotiable instrument is payable to order, its transfer from one person to another is by indorsement, completed by delivery, actual or constructive. *Cartwright v. Coppersmith*, 222 N.C. 573, 24 S.E.2d 246 (1943).

A constructive delivery will be held sufficient if made with the intention of transferring the title, but there must be some unequivocal act, more than the mere expression of an intention or desire. *Cartwright v. Coppersmith*, 222 N.C. 573, 24 S.E.2d 246 (1943); *Sinclair v. Travis*, 231 N.C. 345, 57 S.E.2d 394 (1950).

**Delivery to Other than Payee.**—It is not necessary that delivery be made to

the payee. If the delivery is made to another but shows that the maker intended to part with control, and that it was for the payee's benefit, such delivery is sufficient to bind the maker. *Irvin v. Harris*, 182 N.C. 647, 109 S.E. 867 (1921).

**Presumption of Delivery to Holder in Due Course.**—Where a negotiable municipal bond was in the hands of a holder in due course, it was conclusively presumed under the NIL, that a valid delivery of the bond had been made so far as the rights of the holder were concerned. *Bankers' Trust Co. v. Statesville*, 203 N.C. 399, 166 S.E. 169 (1932).

**Presumption of Delivery to Payee.**—Whenever a bill or note is found in the hands of the payee it will be presumed that it was delivered to him, but the presumption may be rebutted. *Pate v. Brown*, 85 N.C. 166 (1881).

**Indorsement Must Be Proven before Presumptions Arise.**—Where a note was made payable to X or order, indorsement by him was necessary to transfer the title and give the plaintiffs, as the holder, the benefit of the presumptions of the NIL; and proof of such indorsement by the payee was necessary. *Tyson v. Joyner*, 139 N.C. 69, 51 S.E. 803 (1905); *Mayers v. McRimmon*, 140 N.C. 640, 53 S.E. 447 (1906); *Myers v. Petty*, 153 N.C. 462, 69 S.E. 417 (1910); *First-Citizens Bank & Trust Co. v. Raynor*, 243 N.C. 417, 90 S.E.2d 894 (1956).

**And Stamp, "Absence of Endorsement Guaranteed," Does Not Change Requirement.**—Where a bank accepts a check indorsed only for deposit to the credit of the payee, the bank's stamp "absence of



endorsement guaranteed" cannot change the positive law requiring that a negotiable instrument payable to order must be indorsed to constitute the transferee a holder in due course. *First-Citizens Bank & Trust Co. v. Raynor*, 243 N.C. 417, 90 S.E.2d 894 (1956).

**Indorsement with Rubber Stamp Is Valid.**—Where the name of the drawee is stamped on the back of a draft with a rubber stamp, by one having authority to do so and with intent to indorse it, it is a valid indorsement, but does not prove itself. *Mayers v. McRimmon*, 140 N.C. 640, 53 S.E. 447 (1906). See § 25-1-201 (46).

**Physical Attachment Is Prerequisite to Indorsement on Additional Paper.**—While

a lack of room for further indorsements is not a prerequisite to attaching a paper, an essential requirement is that the paper be physically attached or that it should have been when the indorsement was made, and an assignment or transfer on a separate paper will not suffice. *Midgette v. Basnight*, 173 N.C. 18, 91 S.E. 353 (1917); *Commercial Security Co. v. Main St. Pharmacy*, 174 N.C. 655, 94 S.E. 298 (1917).

**Partial Assignment Does Not Entitle Assignee to Sue.**—An assignment of a note, to enable the assignee to sue thereon, must be made by the payee, and must be for the whole, and not for a part of the sum mentioned in the note. *Martin v. Hayes*, 44 N.C. 423 (1853).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 30, 31 and 32, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; new provisions.

**Purposes of changes and new matter:** To make it clear that:

1. Negotiation is merely a special form of transfer, the importance of which lies entirely in the fact that it makes the transferee a holder as defined in Section 1—201. Any negotiation carries a transfer of rights as provided in the section on transfer (subsections (1) and (2) of Section 3—201).

2. Any instrument which has been specially indorsed can be negotiated only with the indorsement of the special indorsee as provided in Section 3—204 on special indorsement. An instrument indorsed in blank may be negotiated by delivery alone, provided that it bears the indorsement of all prior special indorsees.

3. Subsection (2) follows decisions holding that a purported indorsement on a mortgage or other separate paper pinned or clipped to an instrument is not sufficient for negotiation. The indorsement must be on the instrument itself or on a paper intended for the purpose which is so firmly affixed to the instrument as to become an extension or part of it. Such a paper is called an allonge.

4. The cause of action on an instrument cannot be split. Any indorsement which purports to convey to any party less than the entire amount of the instrument is not effective for negotiation. This is true of either "Pay A one-half," or "Pay A two-thirds and B one-third," and neither A nor B becomes a holder. On the other hand an indorsement reading merely "Pay A and B" is effective, since it transfers the entire cause of action to A and B as tenants in common.

The partial indorsement does, however, operate as a partial assignment of the cause of action. The provision makes no attempt to state the legal effect of such an assignment, which is left to the local law. In a jurisdiction in which a partial assignee has any rights, either at law or in equity, the partial indorsee has such rights; and in any jurisdiction where a partial assignee has no rights the partial indorsee has none.

5. Subsection (4) is intended to reject decisions holding that the addition of such words as "I hereby assign all my right, title and interest in the within note" prevents the signature from operating as an indorsement. Such words usually are added by laymen out of an excess of caution and a desire to indicate formally that the instrument is conveyed, rather than with any intent to limit the effect of the signature.

6. Subsection (4) is also intended to reject decisions which have held that the addition of "I guarantee payment" indicates an intention not to indorse but merely to guarantee. Any signature with such added words is an indorsement, and if it is made by a holder is effective for negotiation; but the liability of the indorser may be affected by the words of guarantee as provided in the section on the contract of a guarantor. (Section 3—416.)

#### Cross references:

Section 3—417.

Point 1: Sections 1—201 and 3—201(1) and (2).

Point 2: Section 3—204.

Point 6: Section 3—416.

#### Definitional cross references:

"Bearer". Section 1—201.

"Delivery". Section 1—201.

"Holder". Section 1—201.

"Instrument". Section 3—102.

"Written". Section 1—201.

## NORTH CAROLINA COMMENT

This section states the way in which a "negotiation" is to be made.

*Subsection (1):* This section requires only a delivery for a negotiation of bearer paper, and it requires a delivery and a proper indorsement for a negotiation of order paper.

Prior North Carolina cases dealing with when an actual or constructive delivery has been made are not affected by this section.

*Subsection (2):* This section requires indorsement to be (1) on the instrument or (2) on a paper so firmly affixed as to become a part thereof.

The "on the instrument" requirement continues the rule of GS 25-36 (NIL, 31).

The "so firmly affixed" rule is intended to change the decision of *Colona v. Parksley Nat'l Bank*, 120 Va. 812, 92 S.E. 979 (1917). This case held an indorsement on letter "appended" to a note was an adequate indorsement.

*Subsection (3):* This continues the rule of GS 25-38 under which no North Carolina cases had been decided.

*Subsection (4):* This states that certain words added to an indorsement do not affect its character as an indorsement. But, as noted in Official Comment 6, "the liability of the indorser may be affected

by the words of guarantee as provided in the section on the contract of a guarantor. (Section 3-416)." See North Carolina Comment to GS 25-3-416.

*Words of assignment:* The legal effect of adding words of "assignment" to an indorsement has been a troublesome question in the past, and it is uncertain whether the UCC fully clarifies the problem. The effect of the Code on prior North Carolina decisions is considered below.

In *Evans v. Freeman*, 142 N.C. 70, 54 S.E. 847 (1906), an indorser added the words "I assign all my right, title and interest." Held: This is a "qualified indorsement." To the same effect is *Medlin v. Miles*, 201 N.C. 683, 161 S.E. 207 (1931). Compare *Davidson v. Powell*, 114 N.C. 575, 19 S.E. 601 (1894).

Under subsection (4) such words do not keep such indorsement from still being an indorsement as such. However, whether such words are the equivalent to "without recourse" so as to create a qualified indorsement under GS 25-3-414 (1) and 25-3-417 (3) is not clear. Further study may call for an amendment to one or more of the sections in question.

**§ 25-3-203. Wrong or misspelled name.**—Where an instrument is made payable to a person under a misspelled name or one other than his own he may indorse in that name or his own or both; but signature in both names may be required by a person paying or giving value for the instrument. (1899, c. 733, s. 43; Rev., s. 2192; C. S., s. 3024; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

Prior uniform statutory provision: Section 43, Uniform Negotiable Instruments Law.

**Changes:** Reworded.

**Purposes of changes:** To make it clear that:

1. The party whose name is wrongly designated or misspelled may make an indorsement effective for negotiation by signing in his true name only. This is not commercially satisfactory, since any subsequent purchaser may be left in doubt as to the state of the title; but whether it is done intentionally or through oversight, the party transfers his rights and is liable on his indorsement, and there is a negotiation if identity exists.

2. He may make an effective indorse-

ment in the wrongly designated or misspelled name only. This again is not commercially satisfactory, since his liability as an indorser may require proof of identity.

3. He may indorse in both names. This is the proper and desirable form of indorsement, and any person called upon to pay an instrument or under contract to purchase it may protect his interest by demanding indorsement in both names, and is not in default if such demand is refused.

**Cross reference:**

Section 3—401(2).

**Definitional cross references:**

"Instrument". Section 3—102.

"Person". Section 1—201.

"Signature". Section 3—401.

## NORTH CAROLINA COMMENT

The Official Comment adequately explains this section which makes no real

change in GS 25-49, and there are no North Carolina cases on the matter.

§ 25-3-204. **Special indorsement; blank indorsement.**—(1) A special indorsement specifies the person to whom or to whose order it makes the instrument payable. Any instrument specially indorsed becomes payable to the order of the special indorsee and may be further negotiated only by his indorsement.

(2) An indorsement in blank specifies no particular indorsee and may consist of a mere signature. An instrument payable to order and indorsed in blank becomes payable to bearer and may be negotiated by delivery alone until specially indorsed.

(3) The holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement. (1899, c. 733, ss. 9, 33 to 36, 40; Rev., ss. 2159, 2182 to 2185, 2189; C. S., ss. 2990, 3014 to 3017, 3021; 1949, c. 953; 1965, c. 700, s. 1.)

**Blank Indorsement Presumed to Have Been Intended as Transfer.**—An indorsement in blank by the payee of a note is presumed to have been intended as a transfer thereof. *Davis v. Morgan*, 64 N.C. 570 (1870).

And nothing else appearing, such indorsement constitutes a transfer of the note. *Coffin v. Smith*, 128 N.C. 252, 38 S.E. 864 (1901).

But as between the immediate parties parol evidence is admissible to show a qualified or special contract. *Mendenhall v. Davis*, 72 N.C. 150 (1875); *Hill v. Shields*, 81 N.C. 251 (1879); *Hoffman v. Moore*, 82 N.C. 313 (1880); *First Nat'l Bank v. Pegram*, 118 N.C. 671, 24 S.E. 487 (1896).

**Blank Indorsement Transfers Title to Attorney Holding for Collection.**—A bond indorsed in blank and given to an attorney for collection amounts to an assignment of title, and conveys authority to the attorney to dispose of it as his own. *Parker v. Stallings*, 61 N.C. 590 (1868); *Bradford v. Williams*, 91 N.C. 7 (1884).

**Effect of Blank Indorsement upon Negotiability.**—An indorsement in blank of a nonnegotiable instrument does not make it negotiable. *Johnson v. Lassiter*, 155 N.C. 47, 71 S.E. 23 (1911).

**Blank Indorsement May Be Made Special.**—In case of an indorsement in blank any holder may fill in the blank over the signature thus making it payable to himself or some other person. *Lilly v. Baker*, 88 N.C. 151 (1883).

**But Indorser's Liability Cannot Be Changed.**—By filling in over the indorsement the holder cannot change the indorser's liability. *Lilly v. Baker*, 88 N.C. 151 (1883).

**Time of Filling Blank.**—Where a note is indorsed in blank, the holder has the authority to make it payable to himself or to any other person by filling up the blank over the signature, and this may be done at or before the trial. *Johnson v. Hooker*, 47 N.C. 29 (1854); *Lilly v. Baker*, 88 N.C. 151 (1883). It then becomes a special indorsement. *Tyson v. Joyner*, 139 N.C. 70, 51 S.E. 803 (1905).

**Indorsement Where Note Payable to Bearer.**—Although a note payable to bearer may be transferred by delivery, it may also be transferred by indorsement of the holder, and in such case the indorser incurs the same obligation and liability as an indorser of a note payable to order. *Lilly v. Baker*, 88 N.C. 151 (1883).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 9(5), 33, 34, 35, 36 and 40, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; rule of Section 40 reversed.

**Purposes of changes:**

The last sentence of subsection (1) reverses the rule of the original Section 40, under which an instrument drawn payable to bearer and specially indorsed could be further negotiated by delivery alone. The principle here adopted is that the special indorser, as the owner even of a bearer instrument, has the right to direct the

payment and to require the indorsement of his indorsee as evidence of the satisfaction of his own obligation. The special indorsee may of course make it payable to bearer again by himself indorsing in blank.

**Cross reference:**

Section 3—202.

**Definitional cross references:**

"Bearer". Section 1—201.

"Delivery". Section 1—201.

"Instrument". Section 3—102.

"Person". Section 1—201.

"Signature". Section 3—401.



## NORTH CAROLINA COMMENT

This section combines and rewords several separate NIL sections dealing with special and blank indorsements.

It wisely changes the rule of GS 25-46 (NIL 40), which in effect stated that "face bearer" paper may not be made "order paper" by a special indorsement. Under the last sentence of GS 25-3-204 (1), face bearer paper may be made order paper by a special indorsement.

§ 25-3-205. **Restrictive indorsements.**—An indorsement is restrictive which either

- (a) is conditional; or
- (b) purports to prohibit further transfer of the instrument; or
- (c) includes the words "for collection," "for deposit," "pay any bank," or like terms signifying a purpose of deposit or collection; or
- (d) otherwise states that it is for the benefit or use of the indorser or of another person. (1899, c. 733, ss. 33, 36, 48; Rev., ss. 2182, 2185, 2197; C. S., ss. 3014, 3017, 3029; 1965, c. 700, s. 1.)

An indorsement to "A. B. for sixty days," if conditional, is only a guaranty for sixty days, if unconditional, it is only

*North Carolina Case:* An indorsement to "any bank, banker or trust company" is a special indorsement, and to have a further negotiation there must be an indorsement of one within the class. *Edgecombe Bonded Warehouse Co. v. Security Nat'l Bank*, 216 N.C. 246, 4 S.E.2d 863 (1939).

to be in force for a limited time. *Johnson v. Olive*, 60 N.C. 213 (1864).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 36 and 39, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; new provisions.

**Purposes of changes and new matter:**

1. This section is intended to provide a definition of restrictive indorsements which will include the varieties of indorsement described in original Sections 36 and 39. The separate mention of conditional indorsements, those prohibiting transfer, indorsements in the bank deposit or collection process and other indorsements to a fiduciary, permits separate treatment in subsequent sections where policy so requires.

2. This is part of a series of changes of the prior uniform statutory provisions ef-

fected by Sections 3—102, 3—205, 3—206, 3—304, 3—419, 3—603, and in Article 4, Sections 4—203 and 4—205. The purpose of the changes is generally to require a taker or payor under restrictive indorsement to apply or pay value given consistently with the indorsement, but to provide certain exceptions applying to banks in the collection process (other than depository banks), and to some other takers and payors.

**Cross references:**

Sections 3—102, 3—202(2), 3—205, 3—206, 3—304, 3—419, 3—603, 4—201 and 4—205.

**Definitional cross references:**

"Instrument". Section 3—102.

"Person". Section 1—201.

## NORTH CAROLINA COMMENT

Under NIL 33 (GS 25-39) there were four general categories of indorsements:

- (1) Special or blank. NIL 34 (GS 25-40).
- (2) Qualified or unqualified. NIL 38 (GS 25-44).
- (3) Conditional or unconditional. NIL 39 (GS 25-45).
- (4) Restrictive or nonrestrictive. NIL 36 (GS 25-42).

Actually, a full description of any single indorsement should include one distinguishing term from each of the four categories.

Under the UCC special and blank (GS 25-3-204) and qualified and unqualified (GS

25-3-414 and 25-3-417 (3)) are expressly or impliedly recognized as separate types of indorsement. However, the old conditional indorsement has been merged with restrictive indorsements under this section. See subsection (a) which states that an indorsement is restrictive which is "conditional." This combination approach is not intended to change the law of conditional indorsements as developed under NIL 39 (GS 25-45); however, there are some changes under GS 25-3-205 and 25-3-206 relating to old fashioned restrictive indorsements. See Hawkland, *Commercial Paper* (ALI/ABA Joint Committee on Continuing Legal Education, 1959).

Perhaps the biggest change of GS 25-3-205 is subsection (c) which states that restrictive indorsements include those which contain the words "for collection," "for deposit," "pay any bank," or like terms signifying a purpose of deposit or collection. Under the NIL, there was a considerable difference of opinion as to the effect of such words.

*North Carolina cases:* Murchison Nat'l

Bank v. Dunn Oil Mills Co., 150 N.C. 718, 64 S.E. 885 (1909), held that "for deposit" and "for collection" are restrictive indorsements.

Edgecombe Bonded Warehouse Co., v. Security Nat'l Bank, 216 N.C. 718, 64 S.E.2d 863 (1939), held that "pay any bank . . ." was a special indorsement, but it did not decide whether it was also restrictive.

**§ 25-3-206. Effect of restrictive indorsement.**—(1) No restrictive indorsement prevents further transfer or negotiation of the instrument.

(2) An intermediary bank, or a payor bank which is not the depository bank, is neither given notice nor otherwise affected by a restrictive indorsement of any person except the bank's immediate transferor or the person presenting for payment.

(3) Except for an intermediary bank, any transferee under an indorsement which is conditional or includes the words "for collection," "for deposit," "pay any bank," or like terms (subparagraphs (a) and (c) of § 25-3-205) must pay or apply any value given by him for or on the security of the instrument consistently with the indorsement and to the extent that he does so he becomes a holder for value. In addition such transferee is a holder in due course if he otherwise complies with the requirements of § 25-3-302 on what constitutes a holder in due course.

(4) The first taker under an indorsement for the benefit of the indorser or another person (subparagraph (d) of § 25-3-205) must pay or apply any value given by him for or on the security of the instrument consistently with the indorsement and to the extent that he does so he becomes a holder for value. In addition such taker is a holder in due course if he otherwise complies with the requirements of § 25-3-302 on what constitutes a holder in due course. A later holder for value is neither given notice nor otherwise affected by such restrictive indorsement unless he has knowledge that a fiduciary or other person has negotiated the instrument in any transaction for his own benefit or otherwise in breach of duty (subsection (2) of § 25-3-304). (1899, c. 733, ss. 36, 37, 39, 47; Rev., ss. 2185, 2186, 2188, 2196; C. S., ss. 3017, 3018, 3020, 3028; 1965, c. 700, s. 1.)

**Editor's Note.**—Prior to the passage of the NIL it was uniformly held in this State that a bank holding a note under a restricted indorsement for collection could not bring suit in its own name, but had to bring suit in the name of the indorser. In *Third Nat'l Bank v. Exum*, 163 N.C. 199, 79 S.E. 498 (1913), decided after the NIL was enacted, the same rule was followed,

the court citing prior cases and not referring to the NIL. The case of *First Nat'l Bank v. Rochamora*, 193 N.C. 1, 136 S.E. 259 (1927), decided the same question and followed the prior ruling. In 5 N.C.L. Rev. 369 (1927) there appears a criticism of these cases. See also *Federal Reserve Bank v. Whitford*, 207 N.C. 267, 176 S.E. 584 (1934).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 36, 37, 39 and 47, Uniform Negotiable Instruments Law.

**Changes:** Completely revised.

**Purposes of changes:**

1. Subsections (1) and (2) apply to all four classes of restrictive indorsements defined in Section 3—205. Conditional indorsements and indorsements for deposit or collection, defined in paragraphs (a) and (c) of Section 3—205, are also subject to subsection (3); and trust indorsements as defined in paragraph (d) of Section 3—205 are subject to subsection (4). This section negates the implication which has

sometimes been found in the original Sections 37 and 47, that under a restrictive indorsement neither the indorsee nor any subsequent taker from him could become a holder in due course. By omitting the original Section 47, this Article also avoids any implication that a discharge is effective against a holder in due course. See Section 3—602.

2. Under subsection (1) an indorsement reading "Pay A only," or any other indorsement purporting to prohibit further transfer, is without effect for that purpose. Such indorsements have rarely appeared in reported American cases. Ordinarily

further negotiation will be contemplated by the indorser, if only for bank collection. The indorsee becomes a holder, and the indorsement does not of itself give notice to subsequent parties of any defense or claim of the indorser. Hence this section gives such an indorsement the same effect as an unrestricted indorsement.

3. Subsection (2) permits an intermediary bank (Sections 3—102(3) and 4—105) or a payor bank which is not a depository bank (Sections 3—102(3) and 4—105) to disregard any restrictive indorsement except that of the bank's immediate transferor. Such banks ordinarily handle instruments, especially checks, in bulk and have no practicable opportunity to consider the effect of restrictive indorsements. Subsection (2) does not affect the rights of the restrictive indorser against parties outside the bank collection process or against the first bank in the collection process; such rights are governed by subsections (3) and (4) and Section 3—603.

4. Conditional indorsements are treated by this section like indorsements for deposit or collection. Under subsection (3) any transferee under such an indorsement except an intermediary bank becomes a holder for value to the extent that he acts consistently with the indorsement in paying or applying any value given by him for or on the security of the instrument. Contrary to the original Section 39, subsection (3) permits a transferee under a conditional indorsement to become a holder in due course free of the conditional indorser's claim.

5. Of the indorsements covered by this section those "for collection", "for deposit" and "pay any bank" are overwhelmingly the most frequent. Indorsements "for collection" or "for deposit" may be either special or blank; indorsements "pay any bank" are governed by Section 4—201(2). Instruments so indorsed are almost invariably destined to be lodged in a bank for collection. Subsection (3) requires any transferee other than an intermediary bank to act consistently with the purpose of collection, and Section 3—603 lays down a similar rule for payors not covered by subsection (2).

6. Subsection (4), applying to trust indorsements other than those for deposit or collection (paragraph (d) of Section 3—205) is similar to subsection (3); but

in subsection (4) the duty to act consistently with the indorsement is limited to the first taker under it. If an instrument is indorsed "Pay T in trust for B" or "Pay T for B" or "Pay T for account of B" or "Pay T as agent for B," whether B is the indorser or a third person, T is of course subject to liability for any breach of his obligation as fiduciary. But trustees commonly and legitimately sell trust assets in transactions entirely outside the bank collection process; the trustee therefore has power to negotiate the instrument and make his transferee a holder in due course. Whether transferees from T have notice of a breach of trust such as to deny them the status of holders in due course is governed by the section on notice to purchasers (Section 3—304); the trust indorsement does not of itself give such notice. Payors are immunized either by subsection (2) of this section or by Section 3—603: payment to the trustee or to a purchaser from the trustee is "consistent with the terms" of the trust indorsement under Section 3—603(1) (b).

7. Several sections of Article 3 and Article 4 are explicitly made subject to the rules stated in this section. See Sections 3—306, 3—419, 4—203 and 4—205.

#### Cross references:

Point 1: Sections 3—205 and 3—602.

Point 2: Section 3—205(b).

Point 3: Sections 3—102(3), 3—419(4), 3—603, 4—105, 4—205(2).

Point 4: Section 3—205(a).

Point 5: Sections 3—205, 3—603 and 4—201.

Point 6: Sections 3—205, 3—304 and 3—603.

Point 7: Sections 3—306, 3—419, 4—203 and 4—205.

#### Definitional cross references:

"Bank". Section 1—201.

"Depository bank". Sections 3—102(3) and 4—105.

"Holder in due course". Section 3—302.

"Intermediary bank". Sections 3—102(3) and 4—105.

"Negotiation". Sections 3—102(2) and 3—202.

"Payor bank". Sections 3—102(3) and 4—105.

"Restrictive indorsement". Section 3—205.

"Transfer". Section 3—201.

### NORTH CAROLINA COMMENT

This section completely revises the NIL, and the Official Comments should be carefully examined. In general, the section

lessens the restriction of a restrictive indorsement.

*Subsection (1):* This reverses the NIL



rule that "Pay A only" or similar words would prevent a further negotiation. Despite such words of restriction an instrument may still be negotiated under this section.

*Subsection (2):* Official Comment 2 adequately describes this section which permits certain banks to disregard the restrictive indorsement of any person except the bank's immediate transferor or the person presenting for payment. This will aid banks in the collection process; but it does not affect the rights of the restrictive indorser against parties outside the collection process.

**§ 25-3-207. Negotiation effective although it may be rescinded.—**

(1) Negotiation is effective to transfer the instrument although the negotiation is

(a) made by an infant, a corporation exceeding its powers, or any other person without capacity; or

(b) obtained by fraud, duress or mistake of any kind; or

(c) part of an illegal transaction; or

(d) made in breach of duty.

(2) Except as against a subsequent holder in due course such negotiation is in an appropriate case subject to rescission, the declaration of a constructive trust or any other remedy permitted by law. (1899, c. 733, ss. 22, 58, 59; Rev., ss. 2180, 2207, 2208; C. S., ss. 3012, 3039, 3040; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 22, 58 and 59, Uniform Negotiable Instruments Law.

**Changes:** Completely revised.

**Purposes of changes:** To make it clear that:

1. The original Section 22, which covered only negotiation by an infant or a corporation, is extended by this section to include other negotiations which may be rescinded. The provision applies even though the party's lack of capacity or the illegality, is of a character which goes to the essence of the transaction and makes it entirely void and even though the party negotiating has incurred no liability and is entitled to recover the instrument and have his indorsement cancelled.

2. It is inherent in the character of negotiable paper that any person in possession of an instrument which by its terms runs to him is a holder, and that anyone may deal with him as a holder. The principle finds its most extreme application in the well settled rule that a holder in due course may take the paper even from a thief and be protected against the claim of the rightful owner. Where there is actual negotiation, even in an entirely void transaction, it is no less effective. The policy of this provision, as well as of the last sentence of the original Section 59, is that any person to whom an instrument is nego-

*Subsection (3):* Contrary to NIL 39 (GS 25-45), this subsection permits a transferee under a conditional indorsement to be an HDC free of the indorser's claim if certain conditions are met.

*Subsection (4):* As noted in Official Comment 6, this section is similar to subsection (3), but it applies to trust indorsements other than those for deposit or collection. Also, the duty to act consistently with the indorsement is limited to the first taker under it.

tiated is a holder until the instrument has been recovered from his possession; and that any person who negotiates an instrument thereby parts with all his rights in it until such recovery. The remedy of any such claimant is to recover the paper by replevin or otherwise; to impound it or to enjoin its enforcement, collection or negotiation; to recover its proceeds from the holder; or to intervene in any action brought by the holder against the obligor. As provided in the section or the rights of one not a holder in due course (Section 3—306) his claim is not a defense to the obligor unless he himself defends the action.

3. Negotiation under this Article always includes delivery. (Section 3—202, and see Section 1—201(14)). Acquisition of possession by a thief can therefore never be negotiation under this section. But delivery by the thief to another person may be.

4. Nothing in this section is intended to impose any liability on the party negotiating. He may assert any defense available to him under Sections 3—305, 3—306 and 3—307.

5. A holder in due course takes the instrument free from all claims to it on the part of any person (Section 3—305(1)). Against him there can be no rescission or other remedy, even though the prior negotiation may have been fraudulent or illegal

in its essence and entirely void. As against any other party the claimant may have any remedy permitted by law. This section is not intended to specify what that remedy may be, or to prevent any court from imposing conditions or limitations such as prompt action or return of the consideration received. All such questions are left to the law of the particular jurisdiction. Subsection (2) of Section 3—207 gives no right where it would not otherwise exist. The section is intended to mean that any remedies afforded by the local law are cut off only by a holder in due course, and that other parties, such as a bona fide purchaser with notice that the instrument is overdue, take it subject to the claim as

provided in paragraph (a) of the section on the rights of one not a holder in due course (Section 3—306).

**Cross references:**

Point 2: Sections 1—201 and 3—306(d).

Point 3: Sections 1—201 and 3—202.

Point 4: Sections 3—305, 3—306 and 3—307.

Point 5: Sections 3—305(1) and 3—306(a).

**Definitional cross references:**

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Negotiation". Section 3—202.

"Person". Section 1—201.

"Remedy". Section 1—201.

### NORTH CAROLINA COMMENT

The Official Comments reasonably explain this section. The section as a whole expands the negotiability of instruments.

*Subsection (1):* This subsection expands GS 25-37 (NIL, 22) to permit a negotiation to be effective even though (a) made by any person without capacity, (b) even though there was fraud or duress, (c) even though the negotiation was part of an illegal transaction, or (d) even

though the negotiation was in breach of duty.

Whether or not there may be a rescission or other remedy in such unlawful negotiations is covered in subsection (2).

*Subsection (2):* This recognizes that one who negotiates may have certain remedies (e. g., rescission, trust) in some cases, but not against an HDC. See GS 25-3-305 (1) on HDC.

**§ 25-3-208. Reacquisition.**—Where an instrument is returned to or reacquired by a prior party he may cancel any indorsement which is not necessary to his title and reissue or further negotiate the instrument, but any intervening party is discharged as against the reacquiring party and subsequent holders not in due course and if his indorsement has been cancelled is discharged as against subsequent holders in due course as well. (1899, c. 733, ss. 48, 50, 121; Rev., ss. 2197, 2199, 2271; C. S., ss. 3029, 3031, 3103; 1965, c. 700, s. 1.)

**Editor's Note.**—In 1 N.C.L. Rev. 187 there is a discussion of the NIL which suggests that the rule thereunder was as had been laid down in *Adrian v. McCaskill*, 103 N.C. 182, 9 S.E. 284 (1889), that one who obtained possession of a negotiable instrument after having formerly indorsed it was restored to his former position and could not hold indorsers subsequent to his first indorsement. The reason for this rule was clearly to avoid circuity of action, for the subsequent indorsers would eventually hold him liable under his first indorsement. To the same effect, see *Ray v. Livingston*, 204 N.C. 1, 167 S.E. 496 (1933).

**Indorser Reacquiring Bill May Strike**

**His Indorsement and Sue Prior Parties.**

—An indorser in full, who takes up a bill, is remitted to his former title, and may strike out his indorsement and sue as indorsee those standing before him on the bill, although he may have once made a restrictive indorsement. *French v. Barney*, 23 N.C. 219 (1840).

**Or Sue without Striking Subsequent Indorsees.**

—An indorser of a note may strike out the subsequent indorsers and bring suit, or he may bring suit without striking the subsequent indorsers, as possession is prima facie evidence of payment to the indorsee. *Smith v. St. Lawrence*, 2 N.C. 174 (1795).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 48, 50 and 121, Uniform Negotiable Instruments Law.

**Changes:** Parts of original sections combined and rephrased.

**Purposes of changes:** No change in the substance of the law is intended. "Returned

to or reacquired by" is substituted for "negotiated back to" in the original Section 50 in order to make it clear that the section applies to a return by an indorsee who does not himself indorse. "Discharged" is substituted for the original language to make it clear that the discharge of the in-

intervening party is included within the rule of the section on effect of discharge against a holder in due course (Section 3—602) and is not effective against a subsequent holder in due course who takes without notice of it.

The reacquirer may keep the instrument himself or he may further negotiate it. On further negotiation he may or may not cancel intervening indorsements. In any case intervening indorsers are discharged as to the reacquirer, since if he attempted to enforce it against them they would have an action back against him. Where the

reacquirer negotiates without cancelling the intervening indorsements, the section provides that such indorsers are discharged except against subsequent holders in due course. The intervening indorser whose indorsement is stricken is, in conformity with Section 3—605, discharged even as against subsequent holders in due course.

**Cross references:**

Sections 3—602 3—603(2) and 3—605.

**Definitional cross references:**

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Party". Section 1—201.

### NORTH CAROLINA COMMENT

The most important part of this section relates to the discharge of intervening parties after an instrument has been reacquired. Basically, the section affirms the prior law of NIL, and also affirms several prior North Carolina decisions.

The extent to which an HDC loses his rights against an intervening indorser is also partly covered in GS 25-3-602 which states: "No discharge of any party pro-

vided by the article is effective against a subsequent holder in due course unless he has notice thereof when he takes the instrument."

There are some latent uncertainties in both GS 25-3-208 and 25-3-602; however, no modification is suggested at this time.

The rights of a reacquirer as a derivative HDC are covered in GS 25-3-201.

## PART 3.

### RIGHTS OF A HOLDER.

**§ 25-3-301. Rights of a holder.**—The holder of an instrument whether or not he is the owner may transfer or negotiate it and, except as otherwise provided in § 25-3-603 on payment or satisfaction, discharge it or enforce payment in his own name. (1899, c. 733, s. 51; Rev., s. 2200; C. S., s. 3032; 1965, c. 700, s. 1.)

**Holder May Sue without Proof of Indorsing Signatures.**—Possession of a note raises the presumption that the possessor is a holder thereof and he may sue thereon without proof of the signatures of the

indorsers, since a mere holder of a negotiable instrument may sue thereon in his own name. *Dillingham v. Gardner*, 219 N.C. 227, 13 S.E.2d 478 (1941).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 51, Uniform Negotiable Instruments Law.

**Changes:** Reworded. The provision in the original Section 51 as to discharge by payment is now covered by Section 3—603(1).

**Purposes of changes:** The section is revised to state in one provision all the rights of a holder, and to make it clear that every holder has such rights. The only limitations are those found in Section 3—603 on payment or satisfaction. That section provides (with stated exceptions) that payment to a holder discharges the liability of the party paying even though made with knowledge of a claim of another person to the instrument, unless the adverse claimant

posts indemnity or procures the issuance of appropriate legal process restraining the payment. Thus payment to a holder in an adverse claim situation would not give discharge if the adverse claimant had followed either of the procedures provided for in the "unless" clause of Section 3—603; nor would a discharge result from payment in two other specific situations described in Section 3—603.

**Cross references:**

Sections 1—201, 3—307 and 3—603(1).

**Definitional cross references:**

"Holder". Section 1—201.

"Instrument". Section 3—102.

"Rights". Section 1—201.



## NORTH CAROLINA COMMENT

For North Carolina the most important part of this section pertains to its authorization allowing any holder, "whether or not he is the owner," to enforce payment in his own name.

Under similar wording in GS 25-57 (NIL 51), our court held that a holder collection agent could not sue in his own name because of the "real party in in-

terest" statute, GS 1-57. *First Nat'l Bank v. Rochamora*, 193 N.C. 1, 136 S.E. 259 (1927).

Unless there is some real reason to follow *Rochamora*, GS 25-3-301 should not be amended; and it should be construed as clearly written.

For a criticism of *Rochamora*, see 5 N.C.L. Rev. 369 (1927).

§ 25-3-302. **Holder in due course.**—(1) A holder in due course is a holder who takes the instrument

(a) for value; and

(b) in good faith; and

(c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

(2) A payee may be a holder in due course.

(3) A holder does not become a holder in due course of an instrument:

(a) by purchase of it at judicial sale or by taking it under legal process; or

(b) by acquiring it in taking over an estate; or

(c) by purchasing it as part of a bulk transaction not in regular course of business of the transferor.

(4) A purchaser of a limited interest can be a holder in due course only to the extent of the interest purchased. (1899, c. 733, s. 52; Rev., s. 2201; C. S., s. 3033; 1965, c. 700, s. 1.)

**Instrument Must Be Negotiable.**—The transfer by indorsement to another of a bond indemnifying a bank from any loss which it might sustain by reason of its taking over the assets and discharging the liabilities of another bank, which bond is not payable to order and hence does not comply with the statutory requirements to be a negotiable instrument, is an assignment of a chose in action, and the assignee is not a holder in due course. *North Carolina Bank & Trust Co. v. Williams*, 201 N.C. 464, 160 S.E. 484 (1931).

**Indorsement Is Necessary.**—To constitute a holder in due course it is required that the instrument be indorsed. *Mayers v. McRimmon*, 140 N.C. 640, 53 S.E. 447 (1906); *Planters Bank & Trust Co. v. Yelverton*, 185 N.C. 314, 117 S.E. 299 (1923). See also *Keith v. Henderson County*, 204 N.C. 21, 167 S.E. 481 (1933).

**And without It Holder Is Subject to Equities.**—A holder of a note not indorsed to him is not a holder in due course, and it makes no difference if he had no notice of the equities of the parties, he is subject to them nevertheless. *Steinhilper v. Basnight*, 153 N.C. 293, 69 S.E. 220 (1910).

**But Enlarged Liability of Indorser Does Not Affect Holder.**—A negotiable note indorsed to a holder, bearing an enlarged liability—a guaranty of payment—makes the holder a holder in due course in spite of the enlarged liability of the indorser.

*Richmond Guano Co. v. Walston*, 191 N.C. 797, 133 S.E. 196 (1926).

**Indorsement Implies "Due Course."**—The holder of a negotiable instrument duly indorsed is, prima facie, a purchaser for value, in good faith, before maturity, and without notice of any defect in the title of the person negotiating it. *Smathers v. Toxaway Hotel Co.*, 168 N.C. 69, 84 S.E. 47 (1915); *Worth Co. v. International Feed Co.*, 172 N.C. 335, 90 S.E. 295 (1916).

The admission by the maker of a promissory note that it had been indorsed to the plaintiff in due course raises the presumption prima facie that he is a holder in due course, and the prima facie case is not rebutted by a denial in the pleadings. *Gulf States Steel Co. v. Ford*, 173 N.C. 195, 91 S.E. 844 (1917).

**Holder for Collection Is Not Holder in Due Course.**—A bank taking a note for collection is not a holder in due course. *Manufacturers Fin. Co. v. Amazon Cotton Mills Co.*, 187 N.C. 233, 121 S.E. 439 (1924); *Bank v. Rochamora*, 193 N.C. 1, 136 S.E. 259 (1927). See §§ 25-4-208, 25-4-209.

**Bank Held Not Holder for Collection.**—The fact that there is a custom among banks to take drafts for collection, and charge them back if they are unpaid, is not sufficient evidence to show that a bank holding a draft is not a holder in due course, *Elm City Lumber Co. v. Childer-*

hose, 167 N.C. 34, 83 S.E. 22 (1914); nor will the charging back of a check which is unpaid, make the holder bank a holder for collection, if the back charge was against an account that consisted of deposited checks that were later returned unpaid. *Standard Trust Co. v. Commercial Nat'l Bank*, 240 Fed. 303 (4th Cir. 1917).

**Fraud as Preventing Payee from Being Holder in Due Course.**—Where the indorser alleged in his answer that he signed the note upon representations made by the maker that the payee was lending the money to the maker to finance the equipment of a law office, that in fact the note was given to cover funds of the payee on deposit in a bank which had been wrongfully converted by the maker, and that the payee had full knowledge of, agreed to, and participated in, the fraudulent scheme to procure the indorser to sign the note by such false representations, the answer was sufficiently broad to allege fraud, and the payee was not a holder in due course under this section. *Mitchell v. Strickland*, 207 N.C. 141, 176 S.E. 468 (1934).

**Wrongful Procurement by Agent of Holder.**—Defendant's evidence tended to show that he executed the note in suit to be used to pay for shares of stock of the corporate payee, that the stock was never delivered to him and consequently the note was never delivered by him, but that the note was procured from his office without his knowledge or consent by the president of the payee who was also a collecting agent for a bank, and who turned the note over to the bank as collateral security for his company's note. Held: If in procuring the note the president of the company was acting as an agent of the company, knowl-

edge of the infirmity, nothing else appearing, would not be imputed to the bank and it would be a holder in due course, while if, in procuring the note, he was acting as agent of the bank, it would have imputed knowledge of the infirmity and would not be a holder in due course, and therefore, it being admitted that he was an agent of the bank, an instruction that the maker could not be held liable if the note had been taken by an agent of the bank, without further elaboration, is error. *National Bank v. Marshburn*, 217 N.C. 688, 9 S.E.2d 372 (1940).

**Holder of Note Obtaining Same by Indorsement after Maturity Is Not Holder in Due Course.**—See *Mansfield v. Wade*, 208 N.C. 790, 182 S.E. 475 (1935).

**And Taking Renewal Note Therefor Does Not Cure Defect.**—A bank purchasing a note after maturity takes it subject to the equities of the parties. A subsequent note taken as a renewal of the first will not cure the defect and such holder cannot enforce payment. *Grace & Co. v. Strickland*, 188 N.C. 369, 124 S.E. 856 (1924); *Merchants Nat'l Bank v. Howard*, 188 N.C. 543, 125 S.E. 126 (1924).

**Plaintiff Acquiring Note after Date He Contends It Was Due.**—Where plaintiff acquires a note from the payee subsequent to the date plaintiff contends the note was due, plaintiff may not assert that he was a holder in due course before maturity, and he was not protected by the NIL. *Industrial Distribs., Inc. v. Mitchell*, 255 N.C. 489, 122 S.E.2d 61 (1961).

**Question for Jury.**—Whether the execution of notes was induced by fraudulent representations, held a question for jury. *Clark v. Laurel Park Estates*, 196 N.C. 624, 146 S.E. 584 (1929).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 52, Uniform Negotiable Instruments Law.

**Changes:** Reworded; new provisions.

**Purposes of changes and new matter:** The changes are intended to remove uncertainties arising under the original section.

1. The language "without notice that it is overdue" is substituted for that of the original subsection (2) in order to make it clear that the purchaser of an instrument which is in fact overdue may be a holder in due course if he takes it without notice that it is overdue. Such notice is covered by the section on notice to purchaser (Section 3—304).

2. Subsection (2) is intended to settle

the long continued conflict over the status of the payee as a holder in due course. This conflict has turned very largely upon the word "negotiated" in the original Section 52(4), which is now eliminated. The position here taken is that the payee may become a holder in due course to the same extent and under the same circumstances as any other holder. This is true whether he takes the instrument by purchase from a third person or directly from the obligor. All that is necessary is that the payee meet the requirements of this section. In the following cases, among others, the payee is a holder in due course:

a. A remitter, purchasing goods from P, obtains a bank draft payable to P and forwards it to P, who takes it for value,

in good faith and without notice as required by this section.

b. The remitter buys the bank draft payable to P, but it is forwarded by the bank directly to P, who takes it in good faith and without notice in payment of the remitter's obligation to him.

c. A and B sign a note as comakers. A induces B to sign by fraud, and without authority from B delivers the note to P, who takes it for value, in good faith and without notice.

d. A defrauds the maker into signing an instrument payable to P. P pays A for it in good faith and without notice, and the maker delivers the instrument directly to P.

e. D draws a check payable to P and gives it to his agent to be delivered to P in payment of D's debt. The agent delivers it to P, who takes it in good faith and without notice in payment of the agent's debt to P. But as to this case see Section 3—304(2), which may apply.

f. D draws a check payable to P but blank as to the amount, and gives it to his agent to be delivered to P. The agent fills in the check with an excessive amount, and P takes it for value, in good faith and without notice.

g. D draws a check blank as to the name of the payee, and gives it to his agent to be filled in with the name of A and delivered to A. The agent fills in the name of P, and P takes the check in good faith, for value and without notice.

3. Subsection (3) is intended to state existing case law. It covers a few situations in which the purchaser takes the instrument under unusual circumstances which indicate that he is merely a successor in interest to the prior holder and can acquire no better rights. (If such prior holder was himself a holder in due course, the purchaser succeeds to that status under Section 3—201 on Transfer.) The provision applies to a purchaser at an execution sale, a sale in bankruptcy or a sale by a state bank commissioner of the assets of an insolvent bank. It applies equally to

an attaching creditor or any other person who acquires the instrument by legal process, even under an antecedent claim; and equally to a representative, such as an executor, administrator, receiver or assignee for the benefit of creditors, who takes over the instrument as part of an estate, even though he is representing antecedent creditors.

Subsection (3) (c) applies to bulk purchases lying outside of the ordinary course of business of the seller. It applies, for example, when a new partnership takes over for value all of the assets of an old one after a new member has entered the firm, or to a reorganized or consolidated corporation taking over in bulk the assets of a predecessor. It has particular application to the purchase by one bank of a substantial part of the paper held by another bank which is threatened with insolvency and seeking to liquidate its assets.

4. A purchaser of a limited interest—as a pledgee in a security transaction—may become a holder in due course, but he may enforce the instrument over defenses only to the extent of his interest, and defenses good against the pledgor remain available insofar as the pledgor retains an equity in the instrument. This is merely a special application of the general rule (Section 1—201) that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. Section 27 of the original Act contained a similar provision.

#### Cross references:

Sections 1—201, 3—303, 3—305 and 3—306.

Point 1: Section 3—304(5).

Point 3: Section 3—201.

Point 4: Section 1—201.

#### Definitional cross references:

"Good faith". Section 1—201.

"Holder". Section 1—201.

"Instrument". Section 3—102.

"Notice". Section 1—201.

"Notice of dishonor". Section 3—508.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Purchaser". Section 1—201.

"Value". Section 3—303.

### NORTH CAROLINA COMMENT

By clarifying additions this section broadens somewhat the test for HDC status. For example, a payee can be an HDC if he meets the regular tests (subsection (2)). This rule is implied in *Mitchell v. Strickland*, 207 N.C. 141, 176 S.E. 468 (1934).

To get a full picture of the broadened rules of HDC, this section must be read

in conjunction with GS 25-3-303 (taking for value) and 25-3-304 (notices to purchasers). Many of the prior North Carolina cases on the HDC issue involve "value" and "notice," and some of these are cited under the North Carolina Comments to GS 25-3-303 and 25-3-304.

One of the major changes is to eliminate the requirement of GS 25-58 (NIL, 52)



that one must take an instrument "complete and regular on its face" in order to be an HDC. Under the UCC incompleteness or irregularity is considered only as

a subdivision of the major test of "notice." See North Carolina Comment to GS 25-3-304.

**§ 25-3-303. Taking for value.**—A holder takes the instrument for value

(a) to the extent that the agreed consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process; or

(b) when he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due; or

(c) when he gives a negotiable instrument for it or makes an irrevocable commitment to a third person. (1899, c. 733, ss. 25 to 27, 54; Rev., ss. 2173 to 2175, 2203; C. S., ss. 3005 to 3007, 3035; 1965, c. 700, s. 1.)

**Amount Paid Is Immaterial.**—The title passes to one who takes a negotiable paper without notice of any defect or equities no matter how little he paid, in the absence of fraud. If there is fraud he is only entitled to what he has paid before receiving notice of the fraud. *United States Nat'l Bank v. McNair*, 116 N.C. 550, 21 S.E. 389 (1895).

**The relinquishment of a right of dower was a valid consideration** for a promissory note. *Trust Co. v. Benbow*, 135 N.C. 303, 47 S.E. 435 (1904). As to abolition of dower and right to elect life estate in lieu of intestate share, see §§ 29-4, 29-30.

**Creditor Taking Instrument for Antecedent Debt Holds for Value.**—The transfer of a negotiable note by the holder to his creditor before maturity for an antecedent debt constitutes the transferee a holder for value. *American Exch. Nat'l Bank v. Seagroves*, 166 N.C. 608, 82 S.E. 947 (1914).

A person who accepts a check for a pre-existing debt owed him by the maker is a purchaser for value. *National Bank v. Marshburn*, 229 N.C. 104, 47 S.E.2d 793 (1948).

Many of the courts had prior to the NIL denied that an indebtedness was sufficient consideration to constitute one a holder for value within the meaning of the law merchant. The NIL provisions on this question, however, changed the rule. *Singer Mfg. Co. v. Summers*, 143 N.C. 102, 55 S.E. 522 (1906).

**As Does Assignee of Instrument Transferred to Secure Pre-existing Debt.** — When a negotiable note is transferred before maturity as collateral security for a pre-existing debt, the assignee is such holder for value that he takes free from equities of which he had no notice, to the extent of the debt secured. See *Brooks v. Sullivan*, 129 N.C. 190, 39 S.E. 822 (1901). The law was previously otherwise. *Harris v. Horner*, 21 N.C. 455, 30 Am. Dec.

182 (1836); *Holderby v. Blum*, 22 N.C. 51 (1838); *Potts v. Blackwell*, 56 N.C. 449 (1857).

An interpleader, where a note has been attached, who claims as a holder in due course, and makes it appear that the note was taken as collateral security to another note, is a holder in due course only to the extent of his lien. The balance is subject to attachment. *Sugg v. St. Mary's Oil Engine Co.*, 193 N.C. 815, 138 S.E. 169 (1927).

A bank taking a warehouse receipt as collateral security is a holder in due course to the extent of its lien. *Lacy v. Globe Indem. Co.*, 189 N.C. 24, 126 S.E. 316 (1925).

Where a bank pledged certain bonds to secure the deposit of a town, the town acquired the bonds for value as security for a pre-existing indebtedness which was sufficient to constitute it a holder in due course within the meaning of the NIL. *Standard Inv. Co. v. Snow Hill*, 78 F.2d 33 (4th Cir. 1935).

A note given by incorporators of a land company to secure the holder of a mortgage for the purchase price carries sufficient consideration. *Johnson v. Rodeger*, 119 N.C. 446, 25 S.E. 1021 (1896).

**Unless Note Was Nonnegotiable.**—The provision of the NIL, that a pre-existing debt is sufficient consideration for a promissory note did not apply when the note in question was not negotiable within the meaning of the NIL, and the debt was not contracted by the maker; and where a nonnegotiable note was given by a widow for the defalcation of her husband without consideration, it had to be alleged and shown that she knowingly accepted profit, advantage or benefit from the transaction. *Peoples Bldg. & Loan Ass'n v. Swaim*, 198 N.C. 14, 150 S.E. 668 (1929).

**But Recovery Is Limited to Amount of Consideration Paid or Debt Secured.** — Where the original consideration of the

paper is illegal or fraudulent, or it is taken as collateral security, the right of recovery is restricted to the consideration actually paid by the indorsee before notice of the fraud. *Dresser v. Missouri & I. Ry.*

*Constr. Co.*, 93 U.S. 92, 23 L. Ed. 815 (1876), or the amount of the debt to which it is collateral. *Kerr v. Cowen*, 17 N.C. 356 (1833); *United States Nat'l Bank v. McNair*, 116 N.C. 550, 21 S.E. 389 (1895).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 25, 26, 27 and 54, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; original Section 26 omitted.

**Purposes of changes:** The changes are intended to remove uncertainties arising under the original Act.

1. The original Section 26 which had reference to the liability of accommodation parties is omitted as erroneous and misleading, since a holder who does not himself give value cannot qualify as a holder in due course in his own right merely because value has previously been given for the instrument.

2. In this Article value is divorced from consideration (Section 3—408). The latter is important only on the question of whether the obligation of a party can be enforced against him; while value is important only on the question of whether the holder who has acquired that obligation qualifies as a particular kind of holder.

3. Paragraph (a) resolves an apparent conflict between the original Section 54 and the first sentence of the original Section 25, by requiring that the agreed consideration shall actually have been given. An executory promise to give value is not itself value, except as provided in paragraph (c). The underlying reason of policy is that when the purchaser learns of a defense against the instrument or of a defect in the title he is not required to enforce the instrument, but is free to rescind the transaction for breach of the transferor's warranty (Section 3—417). There is thus not the same necessity for giving him the status of a holder in due course, cutting off claims and defenses, as where he has actually paid value. A common illustration is the bank credit not drawn upon, which can be and is revoked when a claim or defense appears.

4. Paragraph (a) limits the language of the original Section 27, eliminating the attaching creditor or any other person who acquires a lien by legal process. Any such lienor has been uniformly held not to be a holder in due course.

5. Paragraph (b) restates the last sentence of the original Section 25. It adopts the generally accepted rule that the holder takes for value when he takes the instrument as security for an antecedent debt, even though there is no extension of time or other concession, and whether or not the debt is due. The provision extends the same rule to any claim against any person; there is no requirement that the claim arise out of contract. In particular the provision is intended to apply to an instrument given in payment of or as security for the debt of a third person, even though no concession is made in return.

6. Paragraph (c) is new, but states generally recognized exceptions to the rule that an executory promise is not value. A negotiable instrument is value because it carries the possibility of negotiation to a holder in due course, after which the party who gives it cannot refuse to pay. The same reasoning applies to any irrevocable commitment to a third person, such as a letter of credit issued when an instrument is taken.

#### Cross references:

Sections 3—302 and 3—415

Point 1: Section 3—415.

Point 2: Section 3—408.

Point 3: Section 3—417.

#### Definitional cross references:

"Holder". Section 1—201.

"Instrument". Section 3—102.

"Person". Section 1—201.

"Security interest". Section 1—201.

### NORTH CAROLINA COMMENT

Generally, this section defines the "value" requirement of HDC status. One change makes it clear that a holder cannot "tack" the value given by another in order to be HDC. An HDC must himself give value.

The time at which bank credit will be

treated as value by the bank is not fully covered by this section, but "value" by a bank is covered by GS 25-4-209 (when bank gives value for purposes of holder in due course). The value by a bank problem had been an uncertain matter in North Carolina, and a more complete dis-

cussion is given in the North Carolina Comments under GS 25-4-208 and 25-4-209.

The provisions of subsection (a) stating

that a security interest or a lien on an instrument constitute value are in accord with *Sugg v. St. Mary's Oil Engine Co.*, 193 N.C. 814, 138 S.E. 169 (1927).

**§ 25-3-304. Notice to purchaser.**—(1) The purchaser has notice of a claim or defense if

(a) the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay; or

(b) the purchaser has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged.

(2) The purchaser has notice of a claim against the instrument when he has knowledge that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty.

(3) The purchaser has notice that an instrument is overdue if he has reason to know

(a) that any part of the principal amount is overdue or that there is an uncured default in payment of another instrument of the same series; or

(b) that acceleration of the instrument has been made; or

(c) that he is taking a demand instrument after demand has been made or more than a reasonable length of time after its issue. A reasonable time for a check drawn and payable within the states and territories of the United States and the District of Columbia is presumed to be thirty days.

(4) Knowledge of the following facts does not of itself give the purchaser notice of a defense or claim

(a) that the instrument is antedated or postdated;

(b) that it was issued or negotiated in return for an executory promise or accompanied by a separate agreement, unless the purchaser has notice that a defense or claim has arisen from the terms thereof;

(c) that any party has signed for accommodation;

(d) that an incomplete instrument has been completed, unless the purchaser has notice of any improper completion;

(e) that any person negotiating the instrument is or was a fiduciary;

(f) that there has been default in payment of interest on the instrument or in payment of any other instrument, except one of the same series.

(5) The filing or recording of a document does not of itself constitute notice within the provisions of this article to a person who would otherwise be a holder in due course.

(6) To be effective notice must be received at such time and in such manner as to give a reasonable opportunity to act on it. (1899, c. 733, ss. 45, 52, 53, 55, 56; Rev., ss. 2194, 2201, 2202, 2204, 2205; C. S., ss. 3026, 3033, 3034, 3036, 3037; 1965, c. 700, s. 1.)

**Irregularities on Face of Instrument Do Not Charge Holder with Notice.**—Under the NIL, observable irregularities on the face of the instrument did not suffice to affect the rights of a holder in due course. It was necessary that circumstances set out in the NIL should occur in order to charge the holder with notice. *Smathers & Co. v. Toxaway Hotel Co.*, 162 N.C. 346, 78 S.E. 224 (1913); *Smathers & Co. v. Toxaway Hotel Co.*, 167 N.C. 469, 83 S.E. 844 (1914); *Critchler v. Ballard*, 180 N.C. 111, 104 S.E. 134 (1920); *Holleman v. Harnett County Trust Co.*, 185 N.C. 49, 115 S.E.

825 (1923); *Lacy v. Globe Indem. Co.*, 189 N.C. 24, 126 S.E. 316 (1925). And see *Piedmont Carolina Ry. v. Shaw*, 223 Fed. 973 (4th Cir. 1915).

**Nor Do Facts That Note Is Discounted by Stranger and Alternative Place of Payment Is Unknown.**—The fact that a note is negotiated by a stranger at a discount and one of the alternative places of payment was not known to the holder, is not sufficient to put him on notice of the defects. *Farthing v. Dark*, 111 N.C. 243, 16 S.E. 337 (1892). This case was reported in *Farthing v. Dark*, 109 N.C. 291, 13 S.E.



918 (1891), but at that time the court was not advertent to the fact that there was an alternative place of payment.

**But Indorsee with Actual Notice of Fraud Is Subject to Equities.**—When a note is signed through fraud of another, and discounted with an indorsee that had notice of this fraud, the indorsee is subject to the equities between the parties. *Grace & Co. v. Strickland*, 188 N.C. 369, 124 S.E. 856 (1924).

**And Facts Known May Give Rise To Duty to Inquire.**—When a person has knowledge of such facts and circumstances which make it incumbent on him to inquire as to the character of the note which he purchased, he will be affected with knowledge of all that the inquiry would disclose. *Bunting v. Ricks*, 22 N.C. 130, 32 Am. Dec. 699 (1838); *Hulbert v. Douglas*, 94 N.C. 122 (1886); *Loftin v. Hill*, 131 N.C. 105, 42 S.E. 548 (1902).

**But Mere Knowledge of Assignor's Crookedness Is Insufficient.**—Knowledge of the crookedness in business matters of the assignor does not defeat the title of the assignee or make it his duty to inquire relative to the note. *Setzer v. Deal*, 135 N.C. 428, 47 S.E. 466 (1904).

**And fact that interest is past due does not of itself constitute notice of equities** between the parties, but it may be considered by the jury in passing on the issue. *Fidelity Trust Co. v. Whitehead*, 165 N.C. 74, 80 S.E. 1065 (1914).

**Nor Does Statement of Transaction on Face of Note.**—A note containing on its face an express statement of the transaction for which it was given, in the absence of further evidence, is not notice of the equities between the parties. *Bank of Sampson v. Hatcher*, 151 N.C. 359, 66 S.E. 308 (1909). See § 25-3-105 and note thereto.

**Notice to Bank through Officers.**—A note payable to an officer of a bank and discounted at the bank through the discount committee does not make the bank subject to the principle of imputed knowledge when the officer is not a member of the discount committee. *Merchants Nat'l Bank v. Howard*, 188 N.C. 543, 125 S.E. 126 (1924).

A bank taking a note indorsed to it by

its president takes with notice of all equities between the parties, when the president and cashier constitute the discount committee, as notice to the president constitutes notice to the bank. *Le Duc v. Moore*, 111 N.C. 516, 15 S.E. 888 (1892).

**Blank Indorsement Presumed Made When Instrument Executed.**—Indorsements in blank upon negotiable instruments are presumed to be made contemporaneously with the execution of such instrument. *Southerland v. Freemont*, 107 N.C. 565, 12 S.E. 237 (1890).

**And Note with Undated Indorsement to Person Now Deceased Presumed Acquired in Due Course.**—Where a negotiable instrument has been indorsed to a decedent, and it is found among his papers, the indorsement not bearing a date, he is prima facie presumed to have acquired it in due course. *Price Real Estate & Ins. Co. v. Jones*, 191 N.C. 176, 131 S.E. 587 (1926).

**Holder of Cashier's Check Negotiated within Reasonable Time Holds in Due Course.**—Cashier's checks, whether certified or otherwise, are classed with bills of exchange payable on demand; and if negotiated by indorsement for value without notice and within a reasonable time, a holder can maintain the position of a holder in due course. *Singer Mfg. Co. v. Summers*, 143 N.C. 102, 55 S.E. 522 (1906). As to time for presentment, see § 25-3-503.

**Five Days Is Reasonable Time for Negotiating Such Check.**—A cashier's check negotiated to a holder in another state within five days is negotiated in a reasonable time. *Singer Mfg. Co. v. Summers*, 143 N.C. 102, 55 S.E. 522 (1906).

**Notice to Holder Held Question for Jury.**—Where there is conflicting evidence as to notice the holder had of equities between the parties, issue should be submitted to a jury. *Loftin v. Hill*, 131 N.C. 105, 42 S.E. 548 (1902).

**Failure to Instruct on Notice Held Error.**—Where there is evidence that the holder of a negotiable instrument had notice of its infirmity, the question is for the jury, and a failure to instruct thereon is reversible error. *People's Bank & Trust Co. v. Duncan*, 194 N.C. 692, 140 S.E. 610 (1927).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 45, 52, 53, 55 and 56, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; new provisions.

**Purposes of changes and new matter:** The original sections are expanded, with the addition of specific provisions intended

to remove uncertainties in the existing law.

1. "Notice" is defined in Section 1—201.

2. Paragraph (a) of subsection (1) replaces the provision in the original Section 52(1) requiring that the instrument be "complete and regular on its face." An instrument may be blank as to some unnecessary particular, may contain minor

erasures, or even have an obvious change in the date, as where "January 2, 1948" is changed to "January 2, 1949", without even exciting suspicion. Irregularity is properly a question of notice to the purchaser of something wrong, and is so treated here.

3. "Voidable" obligation in paragraph (b) of subsection (1) is intended to limit the provision to notice of defense which will permit any party to avoid his original obligation on the instrument, as distinguished from a set-off or counterclaim.

4. Notice that one party has been discharged is not notice to the purchaser of an infirmity in the obligation of other parties who remain liable on the instrument. A purchaser with notice that an indorser is discharged takes subject to that discharge as provided in the section on effect of discharge against a holder in due course (Section 3—602) but is not prevented from taking the obligation of the maker in due course. If he has notice that all parties are discharged he cannot be a holder in due course.

5. Subsection (2) follows the policy of Section 6 of the Uniform Fiduciaries Act, and specifies the same elements as notice of improper conduct of a fiduciary. Under paragraph (e) of subsection (4) mere notice of the existence of the fiduciary relation is not enough in itself to prevent the holder from taking in due course, and he is free to take the instrument on the assumption that the fiduciary is acting properly. The purchaser may pay cash into the hands of the fiduciary without notice of any breach of the obligation. Section 3—206 should be consulted for the effect of a restrictive indorsement.

6. Subsection (3) removes an uncertainty in the original Act by providing that reason to know of an overdue installment or other part of the principal amount is notice that the instrument is overdue and thus prevents the purchaser from taking in due course. On the other hand subsection (4) (f) makes notice that interest is overdue insufficient, on the basis of banking and commercial practice, the decisions under the original Act, and the frequency with which interest payments are in fact delayed. Notice of default in payment of any other instrument, except an uncured default in another instrument of the same series, is likewise insufficient.

7. Subsection (3) departs from the original Section 52(2) by providing that the purchaser may take accelerated paper, or a demand instrument on which demand has in fact been made, as a holder in due course if he takes without notice of the

acceleration or demand. With this change the original Section 45 is eliminated, as the presumption that any negotiation has taken place before the instrument was in fact overdue is of importance only in aid of a holder in due course. Under this section it is not conclusive that the instrument was in fact overdue when it was negotiated, if the holder takes without notice of that fact.

The "reasonable time after issue" is retained from the original Section 53, but paragraph (c) adds a presumption, as that term is defined in this Act (Section 1—201), that a domestic check is stale after thirty days.

8. Paragraph (a) of subsection (4) rejects decisions holding that an instrument known to be antedated or postdated is not "regular." Such knowledge does not prevent a holder from taking in due course.

9. Paragraph (b) of subsection (4) is to be read together with the provisions of this Article as to when a promise or order is unconditional and as to other writings affecting the instrument (Sections 3—105 and 3—119). Mere notice of the existence of an executory promise or a separate agreement does not prevent the holder from taking in due course, and such notice may even appear in the instrument itself. If the purchaser has notice of any default in the promise or agreement which gives rise to a defense or claim against the instrument, he is on notice to the same extent as in the case of any other information as to the existence of a defense or claim.

10. Paragraph (d) of subsection (4) follows the policy of the original Section 14, under which any person in possession of an instrument has prima facie authority to fill blanks. It is intended to mean that the holder may take in due course even though a blank is filled in his presence, if he is without notice that the filling is improper. Section 3—407 on alteration should be consulted as to the rights of subsequent holders following such an alteration.

11. Subsection (5) is new. It removes an uncertainty arising under the original Act as to the effect of "constructive notice" through public filing or recording.

12. Subsection (6) is new. It means that notice must be received with a sufficient margin of time to afford a reasonable opportunity to act on it, and that a notice received by the president of a bank one minute before the bank's teller cashes a check is not effective to prevent the bank from becoming a holder in due course. See in this connection the provision on notice to an organization, Sec. 1—201(27).

**Cross references:**

Sections 3—201 and 3—302.  
 Point 1: Section 1—201.  
 Point 4: Section 3—602.  
 Point 5: Section 3—206.  
 Point 7: Section 1—201.  
 Point 9: Sections 3—105(1) (b) and (c) and 3—119.  
 Point 10: Section 3—407.  
 Point 12: Section 1—201.  
**Definitional cross references:**  
 "Accommodation party". Section 3—415.  
 "Agreement". Section 1—201.  
 "Alteration". Section 3—407.  
 "Bank". Section 1—201.

"Check". Section 3—104.  
 "Holder in due course". Section 3—302.  
 "Instrument". Section 3—102.  
 "Issue". Section 3—102.  
 "Negotiation". Section 3—202.  
 "Notice". Section 1—201.  
 "Party". Section 1—201.  
 "Person". Section 1—201.  
 "Presumed". Section 1—201.  
 "Promise". Section 3—102.  
 "Purchaser". Section 1—201.  
 "Reasonable time". Section 1—204.  
 "Signed". Section 1—201.  
 "Term". Section 1—201.

**NORTH CAROLINA COMMENT**

This lengthy section and Official Comment cover the troublesome problem of "notice." The Official Comment gives a reasonable explanation of the rewording function of the section. Basically, the section is merely a recodification of the NIL and the better decisions under it.

One major change of this section and GS 25-3-302 is to eliminate the "complete and regular on its face" requirement of HDC status. Under subsection (1) (a) an instrument will give notice of a "claim or defense" only if the instrument is "so incomplete," etc., as to call into question its "validity," etc.

There have been a sizable number of North Carolina cases on whether a party could be an HDC under varying circumstances. However, a restating of these cases

here would add little to a general understanding of the purpose of this section. Any possible conflict between prior decisions made on particularized facts and this section would likely not affect the ordinary dealings in negotiable instruments.

*Subsection (2):* According to the Official Comment 5, this subsection follows the policy of § 6 of the Uniform Fiduciaries Act (GS 32-7). Since GS 32-5, 32-6, and 32-7 adopt somewhat different approaches on "notice" to a taker from a fiduciary, the future relationship between these sections and subsection (2) is somewhat ambiguous.

While no recommendation for amendment is made at this time, a further analysis is suggested.

**§ 25-3-305. Rights of a holder in due course.** — To the extent that a holder is a holder in due course he takes the instrument free from

- (1) all claims to it on the part of any person; and
  - (2) all defenses of any party to the instrument with whom the holder has not dealt except
    - (a) infancy, to the extent that it is a defense to a simple contract; and
    - (b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
    - (c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and
    - (d) discharge in insolvency proceedings; and
- strument. (1899, c. 733, ss. 15, 16, 57; Rev., ss. 2165, 2166, 2206; C. S., ss. 2996, 2997, 3038; 1965, c. 700, s. 1.)

**Under NIL Only Defective Title Prevented Enforcement of Note by Holder in Due Course.**—One taking a note as a holder in due course could, under the NIL, enforce his right against all prior parties, except in case of a defective title. *Davidson v. Powell*, 114 N.C. 575, 19 S.E. 601 (1894); *Bank v. McNair*, 116 N.C. 550, 21 S.E. 389 (1895); *Bank v. Griffin*, 153 N.C. 72, 68 S.E. 919 (1910); *Standing Stone*

*Nat'l Bank v. Walser*, 162 N.C. 53, 77 S.E. 1006 (1913).

**But Maker Could Set Up Defenses against Other Holder.**—The maker of a note could not set up defenses he might have against the payee of the note in an action by a holder in due course, but where the holder was not a holder in due course without notice, the maker could set up all defenses which he might have as against



the payee. *Federal Reserve Bank v. Atmore*, 200 N.C. 437, 157 S.E. 129 (1941).

Under the NIL, where the answer sufficiently alleged that the holder was not a holder in due course for value without notice, all defenses which the defendant might have were presentable under the pleadings. *Federal Reserve Bank v. Atmore*, 200 N.C. 437, 157 S.E. 129 (1941).

**Generally, Bona Fide Holder's Title Was Valid against Everyone.**—Subject to certain limitations, e.g., when a negotiable instrument is declared void by statute, legal incapacity to contract, or fraud in the factum, the rule under the law merchant and also under the NIL was that a bona fide holder of a negotiable instrument in due course held a title valid as against all the world. *State Planters Bank v. Courtesy Motors, Inc.*, 250 N.C. 466, 109 S.E.2d 189 (1959).

**Rights of Holders of Notes Tainted with Usury or Illegality.**—When by statute the paper is void in whole or in part from its inception, as for usury or for gaming or immoral contracts, it is void to the same extent into whosoever hands it may pass, even if acquired before maturity, for value and without notice, and the sole remedy of the holder for the deficiency is against the indorser. *Ward v. Sugg*, 113 N.C. 489, 18 S.E. 717 (1893); *United States Nat'l Bank v. McNair*, 116 N.C. 550, 21 S.E. 389 (1895). As to gaming contracts, see § 16-1 et seq. and notes thereto. As to usury, see § 24-2 and note thereto.

Where the original consideration of the paper is illegal or fraudulent, or it is taken as collateral security, the right of recovery is restricted to the consideration actually paid by the indorsee before notice of the fraud, or the amount of the debt to which it is collateral. But the exception does not extend further, not even to cases where the note was issued without any consideration, though it may be purchased by the indorsee for less than its face value. *United States Nat'l Bank v. McNair*, 116 N.C. 550, 21 S.E. 389 (1895).

When a note, on which the payee has

charged or received usury, and which is negotiable in form, has been indorsed and delivered by the payee, before maturity, for value, and without notice of any defect in the title of the payee, or of any equity which the maker is entitled to enforce against the payee, to a third person, who thereby becomes a holder in due course of the note, such holder in an action on the note may recover of the maker the principal of the note, but cannot recover interest thereon, for the reason that the law declares the promise to pay interest, in such case, void. *Federal Reserve Bank v. Jones*, 205 N.C. 648, 172 S.E. 185 (1934).

Where a borrower is entitled to enforce an equity against the payee because of a device to evade the usury laws, namely, the withholding of a part of the face amount of the note, this equity cannot be enforced against a holder in due course. *Federal Reserve Bank v. Jones*, 205 N.C. 648, 172 S.E. 185 (1934), affirming judgment for face amount of note, less credit for a payment, with interest from date of judgment.

**Presumption of Sanity of Maker.**—There is a rebuttable presumption that a promisor was sane at the time of the execution of a note, and on that question the burden of showing the contrary, as a general rule, is upon the defendant or the person alleging it. *Jones v. Winstead*, 186 N.C. 536, 120 S.E. 89 (1923).

**Contemporaneous Parol Agreements.**—Under the NIL, it was competent to prove a collateral agreement, as between the immediate parties, making a note nonpayable upon a contingency which would deprive the note of all consideration even though the note was under seal. *Farrington v. McNeill*, 174 N.C. 420, 93 S.E. 957 (1917).

But in an action upon a note the defendants were not permitted to set up the defense that as a part of the contemporaneous parol agreement they were given further time, until certain lands had been sold, for such would be in contradiction of the written instrument. *Cherokee County v. Meroney*, 173 N.C. 653, 92 S.E. 616 (1917).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 15, 16 and 57, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; new provisions; rule of original Section 15 reversed.

**Purposes of changes and new matter:**

1. The section applies to any person who is himself a holder in due course, and equally to any transferee who acquires the

rights of one (Section 3—201). "Takes" is substituted for "holds" in the original Section 57 because a holder in due course may still be subject to any claims or defenses which arise against him after he has taken the instrument.

2. The language "all claims to it on the part of any person" is substituted for "any defect of title of prior parties" in the original Section 57 in order to make it clear

that the holder in due course takes the instrument free not only from any claim of legal title but also from all liens, equities or claims of any other kind. This includes any claim for rescission of a prior negotiation, in accordance with the provisions of the section on reacquisition (Section 3—208).

3. "All defenses" includes nondelivery, conditional delivery or delivery for a special purpose. Under this Article such nondelivery or qualified delivery is a defense (Sections 3—306 and 3—307) and the defendant has the full burden of establishing it. Accordingly the "conclusive presumption" of the third sentence of the original Section 16 is abrogated in favor of a rule of law cutting off the defense.

The effect of this section, together with the sections dealing with incomplete instruments (Section 3—115) and alteration (Section 3—407) is to cut off the defense of nondelivery of an incomplete instrument against a holder in due course, and to change the rule of the original Section 15.

4. Paragraph (a) of subsection (2) is new. It follows the decisions under the original Act in providing that the defense of infancy may be asserted against a holder in due course, even though its effect is to render the instrument voidable but not void. The policy is one of protection of the infant against those who take advantage of him, even at the expense of occasional loss to an innocent purchaser. No attempt is made to state when infancy is available as a defense or the conditions under which it may be asserted. In some jurisdictions it is held that an infant cannot rescind the transaction or set up the defense unless he restores the holder to his former position, which in the case of a holder in due course is normally impossible. In other states an infant who has misrepresented his age may be estopped to assert his infancy. Such questions are left to the local law, as an integral part of the policy of each state as to the protection of infants.

5. Paragraph (b) of subsection (2) is new. It covers mental incompetence, guardianship, *ultra vires* acts or lack of corporate capacity to do business, any remaining incapacity of married women, or any other incapacity apart from infancy. Such incapacity is largely statutory. Its existence and effect is left to the law of each state. If under the local law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render

the obligation voidable at the election of the obligor, the defense is cut off.

6. Duress is a matter of degree. An instrument signed at the point of a gun is void, even in the hands of a holder in due course. One signed under threat to prosecute the son of the maker for theft may be merely voidable, so that the defense is cut off. Illegality is most frequently a matter of gaming or usury, but may arise in many other forms under a great variety of statutes. The statutes differ greatly in their provisions and the interpretations given them. They are primarily a matter of local concern and local policy. All such matters are therefore left to the local law. If under that law the effect of the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

7. Paragraph (c) of subsection (2) is new. It follows the great majority of the decisions under the original Act in recognizing the defense of "real" or "essential" fraud, sometimes called fraud in the essence or fraud in the factum, as effective against a holder in due course. The common illustration is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some other document. The theory of the defense is that his signature on the instrument is ineffective because he did not intend to sign such an instrument at all. Under this provision the defense extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms.

The test of the defense here stated is that of excusable ignorance of the contents of the writing signed. The party must not only have been in ignorance, but must also have had no reasonable opportunity to obtain knowledge. In determining what is a reasonable opportunity all relevant factors are to be taken into account, including the age and sex of the party, his intelligence, education and business experience; his ability to read or to understand English, the representations made to him and his reason to rely on them or to have confidence in the person making them; the presence or absence of any third person who might read or explain the instrument to him, or any other possibility of obtaining independent information; and the apparent necessity, or lack of it, for acting without delay.

Unless the misrepresentation meets this test, the defense is cut off by a holder in due course.

8. Paragraph (d) is also new. It is inserted to make it clear that any discharge in bankruptcy or other insolvency proceedings, as defined in this Article, is not cut off when the instrument is purchased by a holder in due course.

9. Paragraph (e) of subsection (2) is also new. Under the notice to purchaser section of this Article (Section 3—304), notice of any discharge which leaves other parties liable on the instrument does not prevent the purchaser from becoming a holder in due course. The obvious case is that of the cancellation of an indorsement, which leaves the maker and prior indorsers liable. As to such parties the purchaser may be a holder in due course, but he takes the instrument subject to the discharge of which he has notice. If he is

without such notice, the discharge is not effective against him (Section 3—602).

**Cross references:**

Point 1: Section 3—201(1).

Point 2: Section 3—208.

Point 3: Sections 3—115(2), 3—306(c), 3—307(2) and 3—407 (3).

Point 9: Sections 3—304(1) (b) and 3—602.

**Definitional cross references:**

“Contract”. Section 1—201.

“Holder in due course”. Section 3—302.

“Insolvency proceedings”. Section 1—201.

“Instrument”. Section 3—102.

“Notice”. Section 1—201.

“Party”. Section 1—201.

“Person”. Section 1—201.

“Term”. Section 1—201.

### NORTH CAROLINA COMMENT

This section states the rights of both (1) a party who is an HDC in his own right and (2) a party who is a derivative HDC under GS 25-3-201.

The Official Comment adequately explains the changes from the NIL. Perhaps the most important change relates to a change in the rule of NIL 15 (GS 25-21). GS 25-21 did not by its terms permit an HDC to recover against one who signed an incomplete and undelivered paper. Under GS 25-3-305, however, an HDC is free of the defense of nondelivery of incomplete paper. Thus, the liability of one who signs such undelivered paper is increased.

Subsection 2 lists the several defenses that are valid even against an HDC. For a collection of North Carolina cases on defenses good against HDC, see North Carolina Digest, Bills and Notes, Key Numbers 372-384. The following North Carolina cases probably are affirmed by this subsection:

Wachovia Bank & Trust Co. v. Crafton, 181 N.C. 404, 107 S.E. 316 (1921), held (dictum), maker of note given for gambling debt not liable to HDC.

Planters Bank & Trust Co. v. Felton, 188 N.C. 384, 124 S.E. 849 (1924), held, maker of note in transaction not complying with Blue Sky Law is liable to HDC. To same effect is Bank v. Hunt, 188 N.C. 377, 124 S.E. 854 (1924).

M. & J. Fin. Corp. v. Rinehardt, 216 N.C. 380, 5 S.E.2d 138 (1939), held, fraud in the factum is a defense against HDC (maker was unable to read). See also Parker v. Thomas, 192 N.C. 798, 136 S.E. 118 (1926). Neither of these cases is clear on the usual rule that one who would plead fraud in the factum must show himself free from negligence, but both strongly imply this requirement.

Federal Reserve Bank v. Jones, 205 N.C. 648, 172 S.E. 185 (1934), held, usury is good defense against HDC.

§ 25-3-306. Rights of one not holder in due course.—Unless he has the rights of a holder in due course any person takes the instrument subject to

(a) all valid claims to it on the part of any person; and

(b) all defenses of any party which would be available in an action on a simple contract; and

(c) the defenses of want or failure of consideration, nonperformance of any condition precedent, nondelivery, or delivery for a special purpose (§ 25-3-408); and

(d) the defense that he or a person through whom he holds the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive indorsement. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party. (1899, c. 733, ss. 16, 28, 58, 59; Rev., ss. 2166, 2176, 2207, 2208; C. S., ss. 2997, 3008, 3039, 3040; 1965, c. 700, s. 1.)

**If Due Course Not Proved, Instrument Is Subject to Defenses as if Nonnegotiable.**

—If plaintiff failed to prove that he was a holder in due course, the notes, although



in his hands as a holder, other than a holder in due course, are subject to the same defenses as if they were nonnegotiable. *Whitman v. York*, 192 N.C. 87, 133 S.E. 427 (1926).

**Thus, past-due instrument, lodged with bank as security, is subject to all defenses.** *Bank v. Loughran*, 126 N.C. 814, 36 S.E. 281 (1900).

**As Is Undorsed Instrument Not Payable to Bearer.**—The transferee of an undorsed instrument not payable to bearer also takes subject to defenses. *Bresee v. Crumpton*, 121 N.C. 122, 28 S.E. 351 (1897).

**Maker May Prove Payment Where Holder Took after Maturity.**—Where the holder of a negotiable note obtained same

by indorsement after maturity, he takes same subject to equities, and the maker of the note may establish as against such holder that the note was paid before it was indorsed to and acquired by the holder. *Mansfield v. Wade*, 208 N.C. 790, 182 S.E. 475 (1935).

**But Purchaser after Maturity Takes Free of Agreement of Third Person to Pay Note.**—A purchaser for value after maturity takes the note free from an agreement by a third person to pay the note when such third person was never a purchaser or holder of the note and the purchaser has no knowledge of such agreement between the maker and the third person. *Pickett v. Fulford*, 211 N.C. 160, 189 S.E. 488 (1937).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 16, 28, 58 and 59, Uniform Negotiable Instruments Law.

**Changes:** Combined, condensed and reworded.

**Purposes of changes:** The changes are intended to remove the following uncertainties arising under the original sections:

1. Any transferee who acquires the rights of a holder in due course under the transfer section of this Article (Section 3—201) is included within the provisions of the preceding Section 305. This section covers any person who neither qualifies in his own right as a holder in due course nor has acquired the rights of one by transfer. In particular the section applies to a bona fide purchaser with notice that the instrument is overdue.

2. "All valid claims to it on the part of any person" includes not only claims of legal title, but all liens, equities, or other claims of right against the instrument or its proceeds. It includes claims to rescind a prior negotiation and to recover the instrument or its proceeds.

3. Paragraph (b) restates the first sentence of the original Section 58.

4. Paragraph (c) condenses the original Sections 16 and 28. Want or failure of consideration is specifically mentioned, as in the original Section 28, in order to make it clear that either is a defense which the defendant has the burden of establishing under the following section of this Article. The language as to an "ascertained or liquidated amount or otherwise" in the original Section 28 is omitted because it is believed to be superfluous. The third sentence of Section 16 is now covered by the preceding section. The fourth sentence is omitted in favor of the rule stated in the following section, which places the full

burden of establishing the defense of non-delivery, conditional delivery or delivery for a special purpose upon the defendant, and makes any presumption unnecessary.

5. Paragraph (d) is substituted for the last sentence of the original Section 59, as a more detailed and explicit statement of the same policy, which is also found in the original Section 22. The contract of the obligor is to pay the holder of the instrument, and the claims of other persons against the holder are generally not his concern. He is not required to set up such a claim as a defense, since he usually will have no satisfactory evidence of his own or the issue; and the provision that he may not do so is intended as much for his protection as for that of the holder. The claimant who has lost possession of an instrument so payable or indorsed that another may become a holder has lost his rights on the instrument, which by its terms no longer runs to him. The provision includes all claims for rescission of a negotiation, whether based in incapacity, fraud, duress, mistake, illegality, breach of trust or duty or any other reason. It includes claims based on conditional delivery or delivery for a special purpose. It includes claims of legal title, lien, constructive trust or other equity against the instrument or its proceeds. The exception made in the case of theft is based on the policy which refuses to aid a proved thief to recover, and refuses to aid him indirectly by permitting his transferee to recover unless the transferee is a holder in due course. The exception concerning restrictive indorsements is intended to achieve consistency with Section 3—603 and related sections.

Nothing in this section is intended to prevent the claimant from intervening in

the holder's action against the obligor or defending the action for the latter, and asserting his claim in the course of such intervention or defense. Nothing here stated is intended to prevent any interpleader, deposit in court or other available procedure under which the defendant may bring the claimant into court or be discharged without himself litigating the claim as a defense. Compare Section 3—803 on vouching in other parties alleged to be liable.

**Cross references:**

Section 3—302.

Point 1: Sections 3—201(1) and 3—305.

Point 2: Section 3—207.

Point 3: Section 3—307(2).

Point 4: Sections 3—305 and 3—307(2).

Point 5: Section 3—803.

**Definitional cross references:**

"Action". Section 1—201.

"Contract". Section 1—201.

"Delivery". Section 1—201.

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Party". Section 1—201.

"Person". Section 1—201.

"Rights". Section 1—201.

**NORTH CAROLINA COMMENT**

This section combines and rewords several sections of the NIL, and it is intended to remove some uncertainties under the NIL. Basically, however, the new rules are about the same as the NIL and decisions in North Carolina.

*Subsection (a)* specifically states that a non-HDC takes subject to claims of third persons, thus rejecting Professor Chafee's thesis that one who is a BFP after maturity takes subject to defenses, but free from claims of others. The rejected theory was based on the premise that the "red

flag of maturity" should be an indication of a possible defense by the maker, but does not per se indicate that some third person might have a claim.

*Subsection (d)* specifically states that a defendant may not set up a *jus tertii* defense or claim of some third person unless the third person himself defends the action for the defendant. This section, however, is not intended to prevent another from intervening. See also GS 25-3-803 on vouching in other parties alleged to be liable.

**§ 25-3-307. Burden of establishing signatures, defenses and due course.**—(1) Unless specifically denied in the pleadings each signature on an instrument is admitted. When the effectiveness of a signature is put in issue

(a) the burden of establishing it is on the party claiming under the signature; but

(b) the signature is presumed to be genuine or authorized except where the action is to enforce the obligation of a purported signer who has died or become incompetent before proof is required.

(2) When signatures are admitted or established, production of the instrument entitles a holder to recover on it unless the defendant establishes a defense.

(3) After it is shown that a defense exists a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course. (1899, c. 733, s. 59; Rev., s. 2208; C. S., s. 3040; 1965, c. 700, s. 1.)

**Cross Reference.**—See notes to §§ 25-3-301, 25-3-302.

**Maker Must Show Lack of Consideration.**—Where, between the original parties, the maker sets up the want of consideration for a note he has made to the payee, as a defense in an action thereon, the burden is upon him to introduce evidence to establish his defense, and his failure to do so will entitle the payee to a judgment in his favor. *Piner v. Brittain*, 165 N.C. 401, 81 S.E. 462 (1914); *Merchants Nat'l Bank v. Andrews*, 179 N.C. 341, 102 S.E. 500 (1920).

**Presumption of Due Course Existed Where Bill of Lading Was Attached.**—

Under the NIL the presumption that the holder was one in due course existed in favor of the holder of a draft payable to order with bill of lading attached. *Willard Mfg. Co. v. Tierney*, 133 N.C. 630, 45 S.E. 1026 (1903); *Mangum v. Mutual Grain Co.*, 184 N.C. 181, 114 S.E. 2 (1922).

**Or Where Duly Negotiated Note Was Found among Decedent's Papers.**—When a properly negotiated note is found among the papers of a deceased person that is prima facie evidence that the holder is a holder in due course, and until it is alleged and shown by a party liable on the note that it is defective, the evidence is sufficient for the administrator of the holder to re-

cover thereon. *Price Real Estate & Ins. Co. v. Jones*, 191 N.C. 176, 131 S.E. 587 (1926).

**This presumption did not exist in favor of a holder of an undorsed note** not payable to bearer. *Tyson v. Joyner*, 139 N.C. 69, 51 S.E. 803 (1905).

**Presumption Operated Where Defective Title Was Not Alleged and Proved.**—Under the NIL the presumption that the holder was one in due course became operative as a matter of course where there was neither allegation nor proof that the title to a negotiable instrument was defective. The holder by indorsement was only required to prove the indorsement in order for him to be deemed *prima facie* a holder in due course. *Moon v. Simpson*, 170 N.C. 335, 87 S.E. 118 (1915).

**But Proof of Defective Title Put Burden on Holder to Show Due Course.**—Under the NIL, when it was shown or admitted that the title of the person who negotiated the instrument was defective, or there is evidence of the fact, it was necessary for a recovery by one claiming to be the holder in due course to show by the greater weight of the evidence that he was such a holder. *Manufacturing Co. v. Summers*, 143 N.C. 102, 55 S.E. 522 (1906); *American Nat'l Bank v. Fountain*, 148 N.C. 590, 62 S.E. 738 (1908); *Merchants Nat'l Bank v. Branson*, 165 N.C. 344, 81 S.E. 410 (1914); *First Nat'l Bank v. Warsaw Drug Co.*, 166 N.C. 99, 81 S.E. 993 (1914); *Smathers v. Toxaway Hotel Co.*, 168 N.C. 69, 84 S.E. 47 (1915); *Moon v. Simpson*, 170 N.C. 335, 87 S.E. 118 (1915); *Whitman v. York*, 192 N.C. 87, 133 S.E. 427 (1926); *Hooker v. Hardee*, 192 N.C. 229, 134 S.E. 485 (1926).

**Since Defective Title Rebutted Presumption.**—The presumption that every holder was a holder in due course did not apply when it was alleged and shown that the negotiable instrument was indorsed by one whose title was defective. *American Exch. Nat'l Bank v. Seagroves*, 166 N.C. 608, 82 S.E. 947 (1914); *Whitman v. York*, 192 N.C. 87, 133 S.E. 427 (1926).

**Thus, Burden Shifted on Proof or Admission of Fraud or Infirmary.**—A holder of a note to show that he is a holder in due course without notice must do so by the greater weight of evidence when the maker pleads and shows fraud, infirmity or defective title. *American Nat'l Bank v. Fountain*, 148 N.C. 590, 62 S.E. 738 (1908); *Myers v. Petty*, 153 N.C. 462, 69 S.E. 417 (1910); *Merchants Nat'l Bank v. Branson*, 165 N.C. 344, 81 S.E. 410 (1914); *Smathers v. Toxaway Hotel Co.*, 168 N.C. 69, 84 S.E. 47 (1915); *Metropolitan Dis-*

*count Co. v. Baker*, 176 N.C. 546, 97 S.E. 495 (1918); *Hooker v. Hardee*, 192 N.C. 229, 134 S.E. 485 (1926).

When a holder of a note admits certain infirmities in the note, in an action to recover on the note, the burden is upon him to show that he is a holder in due course. *Whitman v. York*, 192 N.C. 87, 133 S.E. 427 (1926).

The holder of a negotiable note is presumed to be a holder in due course, but, when its execution is proved to have been obtained by fraud, the burden then shifts to him to prove that he took it before maturity, for value and without notice. *Williams v. Green*, 23 F.2d 796 (4th Cir. 1928).

It was competent for the defendant to introduce evidence as to the quality of goods for which a draft was accepted in order that he might show fraud and deception and where such proof was admitted the burden of proving holding in due course devolved upon holder. *Campbell v. Patton*, 113 N.C. 481, 18 S.E. 687 (1893); *Singer Mfg. Co. v. Summers*, 143 N.C. 102, 55 S.E. 522 (1906); *American Nat'l Bank v. Fountain*, 148 N.C. 590, 62 S.E. 738 (1908); *Park v. Exum*, 156 N.C. 228, 72 S.E. 309 (1911); *Standing Stone Nat'l Bank v. Walser*, 162 N.C. 53, 77 S.E. 1006 (1913); *Fidelity Trust Co. v. Ellen*, 163 N.C. 45, 79 S.E. 263 (1913); *Merchants Nat'l Bank v. Branson*, 165 N.C. 344, 81 S.E. 410 (1914); *Smathers v. Toxaway Hotel Co.*, 168 N.C. 69, 84 S.E. 47 (1915); *Metropolitan Discount Co. v. Baker*, 176 N.C. 546, 97 S.E. 495 (1918).

**Holder Must Prove Indorsement before Maturity.**—A holder by indorsement had to show the instrument had been indorsed before maturity. *Mayers v. McRimmon*, 140 N.C. 640, 53 S.E. 447 (1906).

**Indorsement by Rubber Stamp Does Not Prove Itself.**—An indorsement by a rubber stamp is a valid indorsement but does not prove itself. *Mayers v. McRimmon*, 140 N.C. 640, 53 S.E. 447 (1906).

**Credibility of Holder's Evidence Is for Jury.**—The credibility of the plaintiff's evidence that he is a holder in due course is for the jury. *Manufacturing Co. v. Summers*, 143 N.C. 102, 55 S.E. 522 (1906); *American Nat'l Bank v. Fountain*, 148 N.C. 590, 62 S.E. 738 (1908); *Park v. Exum*, 156 N.C. 228, 72 S.E. 309 (1911); *Standing Stone Nat'l Bank v. Walser*, 162 N.C. 53, 77 S.E. 1006 (1913); *Fidelity Trust Co. v. Ellen*, 163 N.C. 45, 79 S.E. 263 (1913).

Where fraud on the part of the payee in the procurement and issuance of the instrument was shown, the burden of proving due course is shifted to the holder.



Myers v. Petty, 153 N.C. 462, 69 S.E. 417 (1910); Third Nat'l Bank v. Exum, 163 N.C. 199, 79 S.E. 498 (1913); Merchants Nat'l Bank v. Branson, 165 N.C. 344, 81 S.E. 410 (1914); American Exch. Nat'l Bank v. Seagroves, 166 N.C. 608, 82 S.E. 947 (1914); Bank of Varina v. Sherron, 186 N.C. 297, 119 S.E. 497 (1923); Hooker v. Hardee, 192 N.C. 229, 134 S.E. 485 (1926); Whitfield v. Carolina Housing, etc., Corp., 243 N.C. 658, 92 S.E.2d 78 (1956). This rule also applied where the holder admitted infirmities in the instrument. Whitman v. York, 192 N.C. 87, 133 S.E. 427 (1926).

Upon proof of fraud in the inception of the contract, the burden shifts to the holder of a negotiable instrument to show that he is a holder in due course for value and without notice of the infirmity. Hancammon v. Carr, 229 N.C. 52, 47 S.E.2d 614 (1948).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 59, Uniform Negotiable Instruments Law.

**Changes:** Reworded; new provisions.

**Purposes of changes and new matter:**

1. Subsection (1) is new, although similar provisions are found in a number of states. The purpose of the requirement of a specific denial in the pleadings is to give the plaintiff notice that he must meet a claim of forgery or lack of authority as to the particular signature, and to afford him an opportunity to investigate and obtain evidence. Where local rules of pleading permit, the denial may be on information and belief, or it may be a denial of knowledge or information sufficient to form a belief. It need not be under oath unless the local statutes or rules require verification. In the absence of such specific denial the signature stands admitted, and is not in issue. Nothing in this section is intended, however, to prevent amendment of the pleading in a proper case.

The question of the burden of establishing the signature arises only when it has been put in issue by specific denial. "Burden of establishing" is defined in the definitions section of this Act (Section 1—201). The burden is on the party claiming under the signature, but he is aided by the presumption that it is genuine or authorized as stated in paragraph (b). "Presumption" is also defined in this Act (Section 1—201). It means that until some evidence is introduced which would support a finding that the signature is forged or unauthorized the plaintiff is not required

**Proof of Defect in Title of Prior Holder Was Sufficient.** — The burden rests upon the holder, when the title of a prior holder is shown to be defective, to show lack of knowledge of the defect. *Standard Inv. Co. v. Snow Hill*, 78 F.2d 33 (4th Cir. 1935).

**But Denial of Plaintiff's Ownership Did Not Rebut Presumption.** — The prima facie case was not rebutted by a mere denial in the answer of the ownership of the plaintiff. *Causey v. Snow*, 120 N.C. 279, 26 S.E. 775 (1897); *Gulf States Steel Co. v. Ford*, 173 N.C. 195, 91 S.E. 844 (1917).

**Intervener Assumes Burden of Proving Title.** — Where a forwarding bank intervenes and claims title to a draft of a non-resident debtor attached in the hands of a local bank, the burden is on the intervener to show its title to the property attached. *Sterling Mills v. Saginaw Milling Co.*, 184 N.C. 461, 114 S.E. 756 (1922).

to prove that it is authentic. The presumption rests upon the fact that in ordinary experience forged or unauthorized signatures are very uncommon, and normally any evidence is within the control of the defendant or more accessible to him. He is therefore required to make some sufficient showing of the grounds for his denial before the plaintiff is put to his proof. His evidence need not be sufficient to require a directed verdict in his favor, but it must be enough to support his denial by permitting a finding in his favor. Until he introduces such evidence the presumption requires a finding for the plaintiff. Once such evidence is introduced the burden of establishing the signature by a preponderance of the total evidence is on the plaintiff.

Under paragraph (b) this presumption does not arise where the action is to enforce the obligation of a purported signer who has died or become incompetent before the evidence is required, and so is disabled from obtaining or introducing it. "Action" of course includes a claim asserted against the estate of a deceased or an incompetent.

2. Subsection (2) is substituted for the first clause of the original Section 59. Once signatures are proved or admitted, a holder makes out his case by mere production of the instrument, and is entitled to recover in the absence of any further evidence. The defendant has the burden of establishing any and all defenses, not only in the first instance but by a preponderance of the total evidence. The provision

applies only to a holder, as defined in this Act (Section 1—201). Any other person in possession of an instrument must prove his right to it and account for the absence of any necessary indorsement. If he establishes a transfer which gives him the rights of a holder (Section 3—201), this provision becomes applicable, and he is then entitled to recover unless the defendant establishes a defense.

3. Subsection (3) rephrases the last clause of the first sentence of the original Section 59. Until it is shown that a defense exists the issue as to whether the holder is a holder in due course does not arise. In the absence of a defense any holder is entitled to recover and there is no occasion to say that he is deemed *prima facie* to be a holder in due course. When it is shown that a defense exists the plaintiff may, if he so elects, seek to cut off the defense by establishing that he is himself a holder in due course, or that he has acquired the rights of a prior holder in due course (Section 3—201). On this issue he has the full burden of proof by a preponderance of the total evidence. "In all respects" means that he must sustain this burden by affirmative proof that the instrument was taken for value, that it was taken in good faith, and that it was taken without notice (Section 3—302).

Nothing in this section is intended to say that the plaintiff must necessarily prove that he is a holder in due course.

He may elect to introduce no further evidence, in which case a verdict may be directed for the plaintiff or the defendant, or the issue of the defense may be left to the jury, according to the weight and sufficiency of the defendant's evidence. He may elect to rebut the defense itself by proof to the contrary, in which case again a verdict may be directed for either party or the issue may be for the jury. This subsection means only that if the plaintiff claims the rights of a holder in due course against the defense he has the burden of proof upon that issue.

#### Cross references:

Sections 3—305, 3—306, 3—401, 3—403 and 3—404.

Point 1: Section 1—201.

Point 2: Sections 1—201 and 3—201(1).

Point 3: Sections 3—201(1) and 3—302.

#### Definitional cross references:

"Action". Section 1—201.

"Burden of establishing". Section 1—201.

"Defendant". Section 1—201.

"Genuine". Section 1—201.

"Holder". Section 1—201.

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Party". Section 1—201.

"Person". Section 1—201.

"Presumed". Section 1—201.

"Rights". Section 1—201.

"Signature". Section 3—401.

### NORTH CAROLINA COMMENT

This section on burden of proof replaces many of the "presumptions" used in the various sections of the NIL.

The three major procedural steps as outlined in this section are:

(a) Subsection (1) on the issue of valid signatures.

(b) Subsection (2) permitting a holder to recover unless the defendant "establishes a defense."

(c) Subsection (3) requiring a person who wishes the rights of a HDC to estab-

lish all the elements of HDC after a defense has been shown.

As explained in Official Comment 2, one who is not a "holder" but who is in possession of an instrument must also prove his right to it and account for the absence of any indorsement in order to recover on the instrument.

Generally, the section helps to clarify the procedural aspect of a suit on a negotiable instrument in North Carolina, but no major change is made.

## PART 4.

### LIABILITY OF PARTIES.

§ 25-3-401. **Signature.**—(1) No person is liable on an instrument unless his signature appears thereon.

(2) A signature is made by use of any name, including any trade or assumed name, upon an instrument, or by any word or mark used in lieu of a written signature. (1899, c. 733, s. 18; Rev., s. 2167; C. S., s. 2999; 1965, c. 700, s. 1.)

**Name in Body of Instrument Is Not Necessary.**—It is not necessary that the name of the obligor appear in the note, it

is sufficient that he sign it. *Howell v. Parsons*, 89 N.C. 230 (1883).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 18, Uniform Negotiable Instruments Law.

**Changes:** Reworded.

**Purposes of changes:** To make it clear that:

1. No one is liable on an instrument unless and until he has signed it. The chief application of the rule has been in cases holding that a principal whose name does not appear on an instrument signed by his agent is not liable on the instrument even though the payee knew when it was issued that it was intended to be the obligation of one who did not sign. The exceptions made as to collateral and virtual acceptances by the original Sections 134 and 135 are now abrogated by the definition of an acceptance and the rules governing its operation. An allonge is part of the instrument to which it is affixed. Section 3—202(2).

Nothing in this section is intended to prevent any liability arising apart from the instrument itself. The party who does not sign may still be liable on the original obligation for which the instrument was given, or for breach of any agreement to sign, or in tort for misrepresentation, or even on an oral guaranty of payment where the statute of frauds is satisfied. He may of course be liable under any separate writing. The provision is not intended to prevent an estoppel to deny that the party has signed, as where the instrument is purchased in good faith reliance upon his assurance that a forged signature is genuine.

2. A signature may be handwritten, typed, printed or made in any other manner. It need not be subscribed, and may appear in the body of the instrument, as in the case of "I, John Doe, promise to pay —" without any other signature. It may be made by mark, or even by thumbprint. It may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for the purpose. Parol evidence is admissible to identify the signer, and when he is identified the signature is effective.

This section is not intended to affect any local statute or rule of law requiring a signature by mark to be witnessed, or any signature to be otherwise authenticated, or requiring any form of proof. It is to be read together with the provision under which a person paying or giving value for the instrument may require indorsement in both the right name and the wrong one; and with the provision that the absence of an indorsement in the right name may make an instrument so irregular as to call its ownership into question and put a purchaser upon notice which will prevent his taking as a holder in due course.

**Cross references:**

Sections 3—202(2), 3—402 through 3—406.

Point 1: Section 3—410.

Point 2: Section 3—203.

**Definitional cross references:**

"Person". Section 1—201.

"Instrument". Section 3—102.

"Signed". Section 1—201.

"Written". Section 1—201.

## NORTH CAROLINA COMMENT

This simple section makes no real change in North Carolina law. See Official Comment.

**§ 25-3-402. Signature in ambiguous capacity.**—Unless the instrument clearly indicates that a signature is made in some other capacity it is an indorsement. (1899, c. 733, ss. 17, 63; Rev., ss. 1952, 2212, 2341; C. S., ss. 2998, 3044; 1965, c. 700, s. 1.)

**Names on Back of Note Are Indorsers.**—Persons placing their names on the back of a note are, nothing else appearing, indorsers and liable on the note only as indorsers. *Perry v. Taylor*, 148 N.C. 362, 62 S.E. 423 (1908); *Houser v. Fayssoux*, 168 N.C. 1, 83 S.E. 692 (1914); *Bank v. Wilson*, 168 N.C. 557, 84 S.E. 866 (1915); *Meyers v. Battle*, 170 N.C. 168, 86 S.E. 1034 (1915); *Barber v. Absher Co.*, 175 N.C. 602, 96 S.E. 43 (1918); *Gillam v. Walker*, 189 N.C. 189, 126 S.E. 424 (1925); *Dillard v. Farmers Mercantile Co.*, 190 N.C. 225, 129 S.E. 598 (1925).

**Instrument Itself Must Show Other Intention.**—“Appropriate words” indicating an intention to be bound other than as an indorser, as provided by the NIL, had to appear upon the instrument itself or in some sufficient writing attached thereto and becoming an essential and integral part thereof, and parol evidence was not admissible to show that one signing as indorser was primarily liable on the note. *Waddell v. Hood*, 207 N.C. 250, 176 S.E. 558 (1934).

**Such as Showing Indorsers on Back Are Sureties.**—When it is set out in the body of a note that indorsers on the back



are sureties, they will be held liable as sureties and not as indorsers. *Dillard v. Farmers Mercantile Co.*, 190 N.C. 225, 129 S.E. 598 (1925).

**Indorsement by Board of Directors.**—Where a resolution, by the board of directors of a corporation, authorized two of their number, by their signatures, to bind each of the directors individually on any notes due by the company or renewals thereof, the indorsement of such notes, by the two directors so authorized, binds the other directors as indorsers only and not as principals. *Hertford Banking Co. v. Stokes*, 224 N.C. 83, 29 S.E.2d 24 (1944).

**Parol Evidence Excluded.**—Testimony

in direct contradiction of the written agreement as expressed in the indorsement to "guarantee payment of this note . . . with full knowledge of this contract," had to be excluded under the NIL. *Carr v. Clark*, 205 N.C. 265, 171 S.E. 88 (1933).

It is not competent to show that the liability of one whose name is written on the back of a note as an indorser is primary, and not secondary, for the purpose of sustaining the contention that notice of dishonor by nonpayment is dispensed with. *Fourth Nat'l Bank v. Wilson*, 168 N.C. 557, 84 S.E. 866 (1915); *Busbee v. Creech*, 192 N.C. 499, 135 S.E. 326 (1926).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 17(6) and 63, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded.

**Purposes of changes:** The revised language is intended to say that any ambiguity as to the capacity in which a signature is made must be resolved by a rule of law that it is an indorsement. Parol evidence is not admissible to show any other capacity, except for the purpose of reformation of the instrument as it may be permitted under the rules of the particular jurisdiction. The question is to be determined from the face of the instrument alone, and unless the instrument itself makes it clear that he has signed in some other capacity the signer must be treated as an indorser.

The indication that the signature is made in another capacity must be clear without reference to anything but the instrument. It may be found in the language used.

Thus if John Doe signs after "I, John Doe, promise to pay," he is clearly a maker; and "John Doe, witness" is not liable at all. The capacity may be found in any clearly evidenced purpose of the signature, as where a drawee signing in an unusual place on the paper has no visible reason to sign at all unless he is an acceptor. It may be found in usage or custom. Thus by long established practice judicially noticed or otherwise established a signature in the lower right hand corner of an instrument indicates an intent to sign as the maker of a note or the drawer of a draft. Any similar clear indication of an intent to sign in some other capacity may be enough to remove the signature from the application of this section.

**Cross reference:**

Section 3—401.

**Definitional cross references:**

"Instrument". Section 3—102.

"Signature". Section 3—401.

### NORTH CAROLINA COMMENT

This section continues the rule of the NIL that a signer is presumed to be an indorser when it is not clear that he signed in some other capacity.

The Official Comment states that parol evidence is not admissible to show any other capacity, except for reformation of the instrument under the laws of the particular jurisdiction.

It is not possible to exactly predict to what extent parol evidence will be admissible in the future to establish the capacity

of various signers; however, see: (a) *Wrenn v. Lawrence Cotton Mills*, 198 N.C. 89, 150 S.E. 676 (1925). Held: Holder may not show that directors of corporation who signed on back signed as comakers, guarantors or sureties. (b) *Gilliam v. Walker*, 189 N.C. 189, 126 S.E. 434 (1925). Held: "It is a general rule that the true relation subsisting between the several parties bound for the performance of a written obligation may be shown by parol evidence."

**§ 25-3-403. Signature by authorized representative.**—(1) A signature may be made by an agent or other representative, and his authority to make it may be established as in other cases of representation. No particular form of appointment is necessary to establish such authority.

(2) An authorized representative who signs his own name to an instrument

(a) is personally obligated if the instrument neither names the person represented nor shows that the representative signed in a representative capacity;

(b) except as otherwise established between the immediate parties, is personally obligated if the instrument names the person represented but does not show that the representative signed in a representative capacity, or if the instrument does not name the person represented but does show that the representative signed in a representative capacity.

(3) Except as otherwise established the name of an organization preceded or followed by the name and office of an authorized individual is a signature made in a representative capacity. (1899, c. 733, ss. 19 to 21; Rev., ss. 2168 to 2170; C. S., ss. 3000 to 3002; 1965, c. 700, s. 1.)

**Authority of Agent May Not Be Lightly Inferred.**—The power to bind the principal by the making of negotiable paper is an important one, and not lightly to be inferred. It should be conferred directly, unless by necessary implication the duties of the agent cannot be performed without the exercise of the power, or where the power is practically indispensable to accomplish the object of the agency, and the person dealing with the agent must see to it that his authority is adequate. *Bank of Morganton v. Hay*, 143 N.C. 326, 55 S.E. 811 (1906).

**But Power to Indorse May Be Implied.**—The indorsement by an agent is valid although the power to indorse was conferred in a vague way, and the agency is one by implication. *Midgette v. Basnight*, 173 N.C. 18, 91 S.E. 353 (1917).

**Attorney Collecting Note Is Prima Facie without Such Power.**—An attorney to whom a note is sent for collection has, prima facie, no authority to indorse the same in the name of his client, and the purchaser should inquire as to the extent of the attorney's authority. *Sherrill v. Weisiger Clothing Co.*, 114 N.C. 436, 19 S.E. 365 (1894).

**Authority Must Be Proved.**—The fact that a signature is by a duly authorized agent does not prove itself, but the facts must be established by proper testimony. *Midgette v. Basnight*, 173 N.C. 18, 91 S.E. 353 (1917).

**Sufficient Disclosure of Principal to Exempt Agent.**—Where a negotiable instrument is made by an agent for his principal, the agent, in order to exempt himself from liability, must not only name the principal, but must sufficiently show that the signature is that of the principal though done by an agent. A mere description of the relation is not sufficient to relieve the agent of liability. *Lester v. McIntosh*, 101 Ga. 675, 29 S.E. 7 (1897).

**Agreement as to Administrator's Personal Liability.**—Where an administrator signs a note in the name of the estate and thereunder writes his name as administrator, and at the time of the execution of the note the parties agree that he should not be personally liable thereon, the payee may not hold the administrator personally liable thereon, in view of this section. *Bank of Spruce Pines v. Vance*, 205 N.C. 103, 170 S.E. 119 (1933).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 19, 20 and 21, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; original Section 21 omitted.

### Purposes of changes:

1. The definition of "representative" in this Act (Section 1—201) includes an officer of a corporation or association, a trustee, an executor or administrator of an estate, or any person empowered to act for another. It is not intended to mean that a trust or an estate is necessarily a legal entity with the capacity to issue negotiable instruments, but merely that if it can issue them they may be signed by the representative.

The power to sign for another may be an express authority, or it may be implied in law or in fact, or it may rest merely

upon apparent authority. It may be established as in other cases of representation, and when relevant parol evidence is admissible to prove or to deny it.

2. Subsection (2) applies only to the signature of a representative whose authority to sign for another is established. If he is not authorized his signature has the effect of an unauthorized signature (Section 3—404). Even though he is authorized the principal is not liable on the instrument, under the provisions (Section 3—401) relating to signatures, unless the instrument names him and clearly shows that the signature is made on his behalf.

3. Assuming that Peter Pringle is a principal and Arthur Adams is his agent, an instrument might, for example, bear the following signatures affixed by the agent—

- (a) "Peter Pringle", or
- (b) "Arthur Adams" or
- (c) "Peter Pringle by Arthur Adams, Agent", or
- (d) "Arthur Adams, Agent", or
- (e) "Peter Pringle  
Arthur Adams", or
- (f) "Peter Pringle Corporation  
Arthur Adams".

A signature in form (a) does not bind Adams if authorized (Sections 3—401 and 3—404).

A signature as in (b) personally obligates the agent and parol evidence is inadmissible under subsection (2) (a) to disestablish his obligation.

The unambiguous way to make the representation clear is to sign as in (c). Any other definite indication is sufficient, as where the instrument reads "Peter Pringle promises to pay" and it is signed "Arthur Adams, Agent." Adams is not bound if he is authorized (Section 3—404).

Subsection 2(b) adopts the New York (minority) rule of *Megowan v. Peterson*, 173 N. Y. 1 (1902), in such a case as (d); and adopts the majority rule in such a case as (e). In both cases the section admits parol evidence in litigation between the immediate parties to prove signature

by the agent in his representative capacity. Case (f) is subject to the same rule.

4. The original Section 21, covering signatures by "procuration," is omitted. It was based on English practice under which the words "per procuration" added to any signature are understood to mean that the signer is acting under a power of attorney which the holder is free to examine. The holder is thus put on notice of the limited authority, and there can be no apparent authority extending beyond the power of attorney. This meaning of "per procuration" is almost unknown in the United States, and the words are understood by the ordinary banker or attorney to be merely the equivalent of "by." The omission is not intended to suggest that a signature "by procuration" can no longer have the effect which it had under the original Section 21, in any case where a party chooses to use the expression.

#### Cross references:

Point 1: Section 1—201.

Point 2: Sections 3—401(1), 3—404 and 3—405.

#### Definitional cross references:

"Instrument". Section 3—102.

"Person". Section 1—201.

"Representative". Section 1—201.

"Signature". Section 3—401.

### NORTH CAROLINA COMMENT

This section relates to the liability of an authorized representative. The liability of an unauthorized signer is governed by GS 25-3-404 (unauthorized signatures). The liability of an unnamed principal is governed by GS 25-3-401, which states that an unnamed party is not liable on the instrument.

*Subsection (1):* This permits a party's name to be signed by another when authorized. The rule is similar to GS 25-25 (NIL 19), 25-27 (NIL 21) and *Midgett v. Basnight*, 173 N.C. 18, 91 S.E. 353 (1917).

*Subsection (2) (a):* This makes an authorized representative personally liable when neither his representative capacity nor the name of the person represented appears on the instrument. The rule was implied in GS 25-26 (NIL 20).

*Subsection (2) (b):* This covers the liability of a representative where the instrument shows only (1) name of principal or (2) representative capacity of signer, but does not show both of these. In a sense such signing creates an ambiguity as to the

liability of the signing representative, and the ambiguity has been resolved in favor of personal liability of the representative, "except as otherwise established between the immediate parties."

The exception permitting an explanation of capacity between immediate parties is contrary to the wording of NIL 20 (former GS 25-26). See *Bank of Spruce Pines v. Vance*, 205 N.C. 103, 170 S.E. 119 (1933), and 9 N.C.L. Rev. 444.

*Subsection (3):* This awkwardly worded subsection is not explained in the Official Comment, and no satisfactory explanation of the rule was found elsewhere. Apparently, it means that the location of a principal's name on the instrument is not of special importance in determining the liability of the principal and the nonliability of the representative. Also, it appears that the "except as otherwise established" proviso will permit evidence to prove other than a mere representative signature.

Further study may call for a clarifying amendment to this subsection.

**§ 25-3-404. Unauthorized signatures.**—(1) Any unauthorized signature is wholly inoperative as that of the person whose name is signed unless he ratifies it



or is precluded from denying it; but it operates as the signature of the unauthorized signer in favor of any person who in good faith pays the instrument or takes it for value.

(2) Any unauthorized signature may be ratified for all purposes of this article. Such ratification does not of itself affect any rights of the person ratifying against the actual signer. (1899, c. 733, s. 23; Rev., s. 2171; C. S., s. 3003; 1965, c. 700, s. 1.)

**Maker Held Not Liable to Indorser Negligently Not Identifying Payee.**—Where the clerk of the superior court executed a check to the person named in a court order, and the brother of the payee of the check, by fraudulently representing himself to be the payee, took the check to plaintiff and indorsed it in plaintiff's presence by forging the name of his brother, whereupon plaintiff indorsed the check by writing "O. K." and signing his name, plaintiff is not entitled to recover the amount of the check from the clerk individually or in his official capacity, plaintiff's negligence in indorsing the check without attempting to ascertain the identity of the person representing himself to be the payee barring any right to recover. *Keel v. Wynne*, 210 N.C. 426, 187 S.E. 571 (1936).

**A bank is presumed to know the signature of its customers**, and if it pays a forged check, it cannot charge the amount to the account of the depositor, unless the depositor is negligent. *Yarborough v. Bank-*

*ing Loan & Trust Co.*, 142 N.C. 377, 55 S.E. 296 (1906).

**And Must Establish Agency of One Signing Drafts for Another.**—In case of drafts presented for payment by an agent, the bank must be assured of the agency to hold another as principal. Letters of instruction to the agent are not sufficient to show power to draw drafts on the principal. *Bank of Morganton v. Hay*, 143 N.C. 326, 55 S.E. 811 (1906).

**Right of Drawer to Recover from Bank.**—In *McKaughan v. Trust Co.*, 182 N.C. 543, 109 S.E. 355 (1921), commented on in 1 N.C.L. Rev. 40, it is held that when one forges a mortgage and under the forgery obtains a check payable to a third party and he indorses the check in the name of the third party, paying an outstanding debt to the drawer with a part of the funds so obtained, in an action against the bank the drawer can only recover the difference between the amount of the check and the amount paid to the drawer.

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 23, Uniform Negotiable Instruments Law.

**Changes:** Reworded; new provisions.

**Purpose of changes and new matter:** The changes are intended to remove uncertainties arising under the original section:

1. "Unauthorized signature" is a defined term (Section 1—201). It includes both a forgery and a signature made by an agent exceeding his actual or apparent authority.

2. The final clause of subsection (1) is new. It states the generally accepted rule that the unauthorized signature, while it is wholly inoperative as that of the person whose name is signed, is effective to impose liability upon the actual signer or to transfer any rights that he may have in the instrument. His liability is not in damages for breach of a warranty of his authority, but is full liability on the instrument in the capacity in which he has signed. It is, however, limited to parties who take or pay the instrument in good faith; and one who knows that the signature is unauthorized cannot recover from the signer on the instrument.

3. Subsection (2) is new. It settles the

conflict which has existed in the decisions as to whether a forgery may be ratified. A forged signature may at least be adopted; and the word "ratified" is used in order to make it clear that the adoption is retroactive, and that it may be found from conduct as well as from express statements. Thus it may be found from the retention of benefits received in the transaction with knowledge of the unauthorized signature; and although the forger is not an agent, the ratification is governed by the same rules and principles as if he were.

This provision makes ratification effective only for the purposes of this Article. The unauthorized signature becomes valid so far as its effect as a signature is concerned. The ratification relieves the actual signer from liability on the signature. It does not of itself relieve him from liability to the person whose name is signed. It does not in any way affect the criminal law. No policy of the criminal law requires that the person whose name is forged shall not assume liability to others on the instrument; but he cannot affect the rights of the state. While the ratification may be taken into account with other relevant

facts in determining punishment, it does not relieve the signer of criminal liability.

4. The words "or is precluded from denying it" are retained in subsection (1) to recognize the possibility of an estoppel against the person whose name is signed, as where he expressly or tacitly represents to an innocent purchaser that the signature is genuine; and to recognize the negligence which precludes a denial of the signature.

**Cross references:**

Sections 3—307, 3—401, 3—403 and 3—405.

Point 1: Section 1—201.

Point 4: Section 3—406.

**Definitional cross references:**

"Good faith". Section 1—201.

"Instrument". Section 3—102.

"Person". Section 1—201.

"Rights". Section 1—201.

"Signature". Section 3—401.

"Signed". Section 1—201.

"Unauthorized signature". Section 1—201.

"Value". Section 3—303.

**NORTH CAROLINA COMMENT**

This section emphasizes: (1) The nonliability of the person whose name is forged or whose name is added by a representative without authority (actual or apparent) and (2) the liability of the party who forges or makes the unauthorized signature.

It changes the rule of GS 25-28 which stated that such unauthorized signature is "wholly inoperative." It also changes Sey-

mour v. Peoples Bank, 212 N.C. 707, 194 S.E. 464 (1938), which stated: "A forged paper is neither a bill nor a check."

Subsection (2) recognizes that an unauthorized signature may be ratified. See implication to this effect in *Yarborough v. Banking Loan & Trust Co.*, 142 N.C. 377, 55 S.E. 296 (1906).

**§ 25-3-405. Impostors; signature in name of payee.**—(1) An indorsement by any person in the name of a named payee is effective if

(a) an impostor by use of the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee; or

(b) a person signing as or on behalf of a maker or drawer intends the payee to have no interest in the instrument; or

(c) an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest.

(2) Nothing in this section shall affect the criminal or civil liability of the person so indorsing. (1899, c. 733, s. 9; Rev., s. 2159; C. S., s. 2990; 1949, c. 953; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 9(3), Uniform Negotiable Instruments Law.

**Changes:** Reworded; new provisions.

**Purposes of changes and new matter:**

1. This section enlarges the original subsection to include additional situations which it has not been held to cover. The words "fictitious or nonexisting person" have been eliminated as misleading, since the existence or nonexistence of the named payee is not decisive and is important only as it may bear on the intent that he shall have no interest in the instrument. The instrument is not made payable to bearer and indorsements are still necessary to negotiation. The section however recognizes as effective indorsement of the types of paper covered no matter by whom made. This solution is thought preferable to making such instruments bearer paper; on the face of things they are payable to order and a subsequent

taker should require what purports to be a regular chain of indorsements. On the other hand it is thought to be unduly restrictive to require that the actual indorsement be made by the impostor or other fraudulent actor. In most cases the person whose fraud procured the instrument to be issued will himself indorse; when some other third person indorses it will most probably be a case of theft or a second independent fraud superimposed upon the original fraud. In neither case does there seem to be sufficient reason to reverse the rule of the section. To recapitulate: the instrument does not become bearer paper, a purportedly regular chain in indorsements is required, but any person—first thief, second impostor or third murderer—can effectively indorse in the name of the payee.

2. Subsection (1) (a) is new. It rejects decisions which distinguish between face-to-face imposture and imposture by mail

and hold that where the parties deal by mail the dominant intent of the drawer is to deal with the name rather than with the person so that the resulting instrument may be negotiated only by indorsement of the payee whose name has been taken in vain. The result of the distinction has been under some prior law, to throw the loss in the mail imposture forward to a subsequent holder or to the drawee. Since the maker or drawer believes the two to be one and the same, the two intentions cannot be separated, and the "dominant intent" is a fiction. The position here taken is that the loss, regardless of the type of fraud which the particular impostor has committed, should fall upon the maker or drawer.

"Imposter" refers to impersonation and does not extend to a false representation that the party is the authorized agent of the payee. The maker or drawer who takes the precaution of making the instrument payable to the principal is entitled to have his indorsement.

3. Subsection (1) (b) restates the substance of the original subsection 9(3). The test stated is not whether the named payee is "fictitious," but whether the signer intends that he shall have no interest in the instrument. The following situations illustrate the application of the subsection.

a. The drawer of a check, for his own reasons, makes it payable to P knowing that P does not exist.

b. The drawer makes the check payable in the name of P. A person named P exists, but the drawer does not know it.

c. The drawer makes the check payable to P, an existing person whom he knows, intending to receive the money himself and that P shall have no interest in the check.

d. The treasurer of a corporation draws its check payable to P, who to the knowledge of the treasurer does not exist.

e. The treasurer of a corporation draws its check payable to P. P exists but the treasurer has fraudulently added his name to the payroll intending that he shall not receive the check.

f. The president and the treasurer of a corporation both sign its check payable to P. P does not exist. The treasurer knows it but the president does not.

g. The same facts as f, except that P exists and the treasurer knows it, but intends that P shall have no interest in the check.

In all the cases stated an indorsement by any person in the name of P is effective.

4. Paragraph (c) is new. It extends the rule of the original subsection 9(3) to include the padded payroll cases, where the drawer's agent or employee prepares the check for signature or otherwise furnishes the signing officer with the name of the payee. The principle followed is that the loss should fall upon the employer as a risk of his business enterprise rather than upon the subsequent holder or drawee. The reasons are that the employer is normally in a better position to prevent such forgeries by reasonable care in the selection or supervision of his employees, or, if he is not, is at least in a better position to cover the loss by fidelity insurance; and that the cost of such insurance is properly an expense of his business rather than of the business of the holder or drawee.

The provision applies only to the agent or employee of the drawer, and only to the agent or employee who supplies him with the name of the payee. The following situations illustrate its application.

a. An employee of a corporation prepares a padded payroll for its treasurer, which includes the name of P. P does not exist, and the employee knows it, but the treasurer does not. The treasurer draws the corporation's check payable to P.

b. The same facts as a, except that P exists and the employee knows it but intends him to have no interest in the check. In both cases an indorsement by any person in the name of P is effective and the loss falls on the corporation.

5. The section is not intended to affect criminal liability for forgery or any other crime, or civil liability to the drawer or to any other person. It is to be read together with the section under which an unauthorized signer is personally liable on the signature to any person who takes the instrument in good faith (3-404(1)).

#### Cross references:

Sections 3-401, 3-403, 3-404 and 3-406.

Point 5: Section 3-404(1)

Definitional cross references.

"Instrument". Section 3-102.

"Issue". Section 3-102.

"Person". Section 1-201.

"Signature". Section 3-401.

#### NORTH CAROLINA COMMENT

This section codifies the better rules relating to "imposters" and "payroll padders"

as previously solved under the NIL by the "fictitious payee" fiction.



This section employs some changes in techniques, but the results are about the same. The new techniques are:

(1) "Impostor" and "fictitious payee" papers do not become "bearer papers."

(2) A purportedly regular indorsement is required.

(3) But any person may effectively indorse in the name of the payee.

No real change is made in North Carolina law.

*Note:* Further study may call for an amendment to broaden the applicability of the principle of this section. At present it is limited to signatures in the name of a "payee."

**§ 25-3-406. Negligence contributing to alteration or unauthorized signature.**—Any person who by his negligence substantially contributes to a material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority against a holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. This section is new. It adopts the doctrine of *Young v. Grote*, 4 Bing. 253 (1827), which held that a drawer who so negligently draws an instrument as to facilitate its material alteration is liable to a drawee who pays the altered instrument in good faith. It should be noted that the rule as stated in the section requires that the negligence "substantially" contribute to the alteration.

2. The section extends the above principle to the protection of a holder in due course and of payors who may not technically be drawees. It rejects decisions which have held that the maker of a note owes no duty of care to the holder because at the time the instrument is drawn there is no contract between them. By drawing the instrument and "setting it afloat upon a sea of strangers" the maker or drawer voluntarily enters into a relation with later holders which justifies his responsibility. In this respect an instrument so negligently drawn as to facilitate alteration does not differ in principle from an instrument containing blanks which may be filled.

The holder in due course under the rules governing alteration (Section 3—407) may enforce the altered instrument according to its original tenor. Where negligence of the obligor has substantially contributed to the alteration, this section gives the holder the alternative right to enforce the instrument as altered.

3. No attempt is made to define negligence which will contribute to an alteration. The question is left to the court or the jury upon the circumstances of the particular cases. Negligence usually has been found where spaces are left in the body of the instrument in which words or

figures may be inserted. No unusual precautions are required, and the section is not intended to change decisions holding that the drawer of a bill is under no duty to use sensitized paper, indelible ink or a protectograph; or that it is not negligence to leave spaces between the lines or at the end of the instrument in which a provision for interest or the like can be written.

4. The section applies only where the negligence contributes to the alteration. It must afford an opportunity of which advantage is in fact taken. The section approves decisions which have refused to hold the drawer responsible where he has left spaces in a check but the payee erased all the writing with chemicals and wrote in an entirely new check.

5. This section does not make the negligent party liable in tort for damages resulting from the alteration. Instead it estops him from asserting it against the holder in due course or drawee. The reason is that in the usual case the extent of the loss, which involves the possibility of ultimate recovery from the wrongdoer, cannot be determined at the time of litigation, and the decision would have to be made on the unsatisfactory basis of burden of proof. The holder or drawee is protected by an estoppel, and the task of pursuing the wrongdoer is left to the negligent party. Any amount in fact recovered from the wrongdoer must be held for the benefit of the negligent party under ordinary principles of equity.

6. The section protects parties who act not only in good faith (Section 1—201), but also in observance of the reasonable standards of their business. Thus any bank which takes or pays an altered check which ordinary banking standards would require

it to refuse cannot take advantage of the estoppel.

7. The section applies the same rule to negligence which contributes to a forgery or other unauthorized signature, as defined in this Act (Section 1—201). The most obvious case is that of the drawer who makes use of a signature stamp or other automatic signing device and is negligent in looking after it. The section extends, however, to cases where the party has notice that forgeries of his signature have occurred and is negligent in failing to prevent further forgeries by the same person. It extends to negligence which contributes to a forgery of the signature of another, as in the case where a check is negligently mailed to the wrong person having the same name as the payee. As

in the case of alteration, no attempt is made to specify what is negligence, and the question is one for the court or the jury on the facts of the particular case.

#### Cross references:

Sections 3—401 and 3—404.

Point 2: Section 3—407(3).

Point 6: Section 1—201.

Point 7: Section 1—201.

#### Definitional cross references:

"Alteration". Section 3—407.

"Good faith". Section 1—201.

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Person". Section 1—201.

"Unauthorized signature". Section 1—201.

### NORTH CAROLINA COMMENT

This new section codifies the rule that negligence of a party will at times preclude him from pleading alteration or lack of authority.

Note that this section covers negligence; but in GS 25-3-405 negligence is immaterial.

Note also that under this section a negligent party is not liable in tort. Instead he is estopped from asserting an alteration or

an unauthorized signature against an HDC or drawee. Probably no real change in North Carolina law is made.

When an alteration is involved, the next section must be read in conjunction with this section.

See *Broad St. Bank v. National Bank*, 183 N.C. 463, 112 S.E. 11 (1922), held, failure of drawer to use sensitized paper to prevent chemical erasures is not negligence.

**§ 25-3-407. Alteration.**—(1) Any alteration of an instrument is material which changes the contract of any party thereto in any respect, including any such change in

(a) the number or relations of the parties; or

(b) an incomplete instrument, by completing it otherwise than as authorized; or

(c) the writing as signed, by adding to it or by removing any part of it.

(2) As against any person other than a subsequent holder in due course

(a) alteration by the holder which is both fraudulent and material discharges any party whose contract is thereby changed unless that party assents or is precluded from asserting the defense;

(b) no other alteration discharges any party and the instrument may be enforced according to its original tenor, or as to incomplete instruments according to the authority given.

(3) A subsequent holder in due course may in all cases enforce the instrument according to its original tenor, and when an incomplete instrument has been completed, he may enforce it as completed. (1899, c. 733, ss. 14, 15, 124, 125; Rev., ss. 2164, 2165, 2274, 2275; C. S., ss. 2995, 2996, 3106, 3107; 1965, c. 700, s. 1.)

**Material Alteration Avoids Bond.**—It is familiar learning that if the payee of a bond alters it in any material part, without the consent of the obligor, the bond is avoided and may be defeated on the plea of non est factum. *Mathis v. Mathis*, 20 N.C. 55 (1838); *Davis v. Coleman*, 29 N.C. 424 (1847); *Dunn v. Clements*, 52 N.C. 58 (1859); *Dunn v. Rippey*, 63 N.C. 319 (1869).

**Adding "in Specie" Is Material Alteration.**—Adding the words "in specie" after

the word "dollars" in a note is a material alteration. *Darwin v. Rippey*, 63 N.C. 319 (1869).

**As Is Substituting Name of Maker.**—The cutting off the name of one of the makers of a promissory note and substituting that of another was a material alteration of the note, and vitiated it. *Davis v. Coleman*, 29 N.C. 424 (1847).

**Or Substituting Name of Prior Indorser.**—Where the payee of a negotiable instrument acquired it with certain indorsers

thereon and subsequently struck out the name of one indorser and another signed as indorser in lieu of the indorser whose name was stricken out, the change was a material one under the NIL, and released the indorsers who had not consented to the substitution, but did not release those indorsers whose consent had been procured. *Efrd v. Little*, 205 N.C. 583, 172 S.E. 198 (1934).

**What Are Immaterial Alterations.**—The addition that does not vary the terms of the contract, and adds nothing more than is already implied by law is not sufficient to be construed as a material alteration. *Houston v. Potts*, 64 N.C. 33 (1870).

**Liability Where Amount Left Blank.**—

See *McArthur v. McLeod*, 51 N.C. 476 (1859); *Humphreys v. Finch*, 97 N.C. 303, 1 S.E. 870 (1887); *Phillips v. Hensley*, 175 N.C. 23, 94 S.E. 673 (1917).

**Liability Where Payee's Name Left Blank.**—A bill of exchange drawn and issued in blank for the name of the payee may be filled up by a bona fide holder with his own name, and will bind the drawer. *Lawrence v. Mabry*, 13 N.C. 473 (1830).

**Same — Acknowledgment after Completion.**—If the maker of a sealed note, blank as to the payee's name, acknowledges it to be his bond after the insertion of the payee's name, and delivery, it is valid and its maker is liable thereon. *Wester v. Bailey*, 118 N.C. 193, 24 S.E. 9 (1896).

## OFFICIAL COMMENT

Prior uniform statutory provision: Sections 14, 15, 124 and 125, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; new provisions; rule of original Section 15 reversed.

**Purposes of changes and new matter:** The changes are intended to remove uncertainties arising under the original sections, and to modify the rules as to discharge:

1. Subsection (1) substitutes a general definition for the list of illustrations in the original Section 125. Any alteration is material only as it may change the contract of a party to the instrument; and the addition or deletion of words which do not in any way affect the contract of any previous signer is not material. But any change in the contract of a party, however slight, is a material alteration; and the addition of one cent to the amount payable, or an advance of one day in the date of payment, will operate as a discharge if it is fraudulent.

Specific mention is made of a change in the number or relations of the parties in order to make it clear that any such change is material only if it changes the contract of one who has signed. The addition of a comaker or a surety does not change in most jurisdictions the contract of one who has already signed as maker and should not be held material as to him. The addition of the name of an alternative payee is material, since it changes his obligation. Paragraph (c) makes special mention of a change in the writing signed in order to cover occasional cases of addition of sticker clauses, scissoring or perforating instruments where the separation is not authorized.

2. Paragraph (b) of subsection (1) is to be read together with Section 3—115 on

incomplete instruments. Where an instrument contains blanks or is otherwise incomplete, it may be completed in accordance with the authority given and is then valid and effective as completed. If the completion is unauthorized and has the effect of changing the contract of any previous signer, this provision follows the generally accepted rule in treating it as a material alteration which may operate as a discharge.

3. Subsection (2) modifies the very rigorous rule of the original Section 124. The changes made are as follows:

a. A material alteration does not discharge any party unless it is made by the holder. Spoliation by any meddling stranger does not affect the rights of the holder. It is of course intended that the acts of the holder's authorized agent or employee, or of his confederates, are to be attributed to him.

b. A material alteration does not discharge any party unless it is made for a fraudulent purpose. There is no discharge where a blank is filled in the honest belief that it is as authorized; or where a change is made with a benevolent motive such as a desire to give the obligor the benefit of a lower interest rate. Changes favorable to the obligor are unlikely to be made with any fraudulent intent; but if such an intent is found the alteration may operate as a discharge.

c. The discharge is a personal defense of the party whose contract is changed by the alteration, and anyone whose contract is not affected cannot assert it. The contract of any party is necessarily affected, however, by the discharge of any party against whom he has a right of recourse on the instrument. Assent to the alteration given before or after it is made will prevent the party from asserting the dis-



charge. "Or is precluded from asserting the defense" is added in paragraph (a) to recognize the possibility of an estoppel or other ground barring the defense which does not rest on assent.

d. If the alteration is not material or if it is not made for a fraudulent purpose there is no discharge, and the instrument may be enforced according to its original tenor. Where blanks are filled or an incomplete instrument is otherwise completed there is no original tenor but the instrument may be enforced according to the authority in fact given.

4. Subsection (3) combines the final sentences of the original Sections 14 and 124, and provides that a subsequent holder in due course takes free of the discharge in all cases. The provision is merely one form of the general rule governing the effect of discharge against a holder in due course (Section 3—602). The holder in due course may enforce the instrument according to its original tenor. In this connection reference should be made to the section giving the holder in due course the right, where the maker's or drawer's negligence has substantially contributed to the alteration, to enforce the instrument in its altered form (Section 3—406). Reference should also be made to Section 4—401 covering a bank's right to charge its customer's account in the case of altered instruments.

Where blanks are filled or an incomplete instrument is otherwise completed, this subsection follows the original Section 14 in placing the loss upon the party who

left the instrument incomplete and permitting the holder to enforce it in its completed form. As indicated in the comment to Section 3—115 on incomplete instruments, this result is intended even though the instrument was stolen from the maker or drawer and completed after the theft; and the effect of this subsection, together with the section on incomplete instruments is to reverse the rule of the original Section 15.

There is no inconsistency between subsection (3) and paragraph (b) of subsection (2). The holder in due course may elect to enforce the instrument either as provided in that paragraph or as provided in subsection (3).

It should be noted that a purchaser who takes the instrument with notice of any material alteration, including the unauthorized completion of an incomplete instrument, takes with notice of a claim or defense and cannot be a holder in due course (Section 3—304).

#### Cross references:

Sections 3—305, 3—306 and 3—307.

Point 2: Section 3—115.

Point 4: Sections 3—115, 3—304(2), 4—401 and 3—602.

#### Definitional cross references:

"Contract" Section 1—201.

"Holder". Section 1—201.

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Party". Section 1—201.

"Person" Section 1—201.

"Signed". Section 1—201.

"Writing". Section 1—201.

### NORTH CAROLINA COMMENT

This is an important section, and the Official Comment should be studied to get a full appreciation of it. Basically, it combines in one section the former rules on incomplete instruments (GS 25-20) and materially altered instruments (GS 25-131).

The rule of GS 25-21 (NIL, 15) on undelivered and incomplete instruments has been reversed. Also, subsection 1 (b) must be read with GS 25-3-115 on incomplete instruments.

*North Carolina cases:* Phillips v. Hens-

ley, 175 N.C. 23, 94 S.E. 673 (1917). Held: Maker liable on note for amount filled up when issued in blank. Affirmed by this section.

Broad St. Bank v. National Bank, 183 N.C. 463, 112 S.E. 11 (1922). Held: Drawer of completed check written in ink liable only for original tenor after instrument is fraudulently raised. Affirmed by this section. Failure to use sensitized paper to prevent chemical erasures is not negligence.

**§ 25-3-408. Consideration.**—Want or failure of consideration is a defense as against any person not having the rights of a holder in due course (§ 25-3-305), except that no consideration is necessary for an instrument or obligation thereon given in payment of or as security for an antecedent obligation of any kind. Nothing in this section shall be taken to displace any statute outside this chapter under which a promise is enforceable notwithstanding lack or failure of consideration. Partial failure of consideration is a defense pro tanto whether or not the failure is in an ascertained or liquidated amount. (1899, c. 733, ss. 24, 25, 28; Rev., ss. 2172, 2173, 2176; C. S., ss. 3004, 3005, 3008; 1965, c. 700, s. 1.)

**Want of Consideration Is Defense against Payee.**—A total absence of consideration is a matter of defense by the maker against the original payee. *Swift & Co. v. Aydtlett*, 192 N.C. 330, 135 S.E. 141 (1926).

**Except Where Instrument Is under Seal.**—The lack of consideration cannot benefit a maker of a bond under seal because the law conclusively presumes that it was made upon good and sufficient consideration. *Angier v. Howard*, 94 N.C. 27 (1886); *Wester v. Bailey*, 118 N.C. 193, 24 S.E. 9 (1896).

A note given for the purchase price of fertilizer reciting that there is no warranty is subject to the defense of lack of consideration, and if it appears that the fertilizer was not the grade as shown by the analysis on the sack, the plaintiff is not entitled to recover on the note. *Swift v. Etheridge*, 190 N.C. 162, 129 S.E. 453 (1925).

**Failure of Consideration May Be Shown.**—A contract for carrying mail is not assignable, and in an action on a note given in part consideration of such assignment this may be shown as a failure of consideration, except as against a holder for value, in due course, without notice. *Peoples Bank & Trust Co. v. Duncan*, 194 N.C. 692, 140 S.E. 610 (1927).

**Without Violating Parol Evidence Rule.**—The rule which prohibits the introduction of parol evidence to vary, modify or contradict the terms of a written instrument, is not violated by showing failure of consideration. *Virginia Trust Co. v. Asheville*, 207 N.C. 164, 176 S.E. 257 (1934); *Mills v. Bonin*, 239 N.C. 498, 80 S.E.2d 365 (1954).

**Failure of consideration is an affirmative defense** and therefore must be specifically pleaded by setting out the applicable facts. *Diemar & Kirk Co. v. Smart Styles, Inc.*, 261 N.C. 156, 134 S.E.2d 134 (1964).

Failure of consideration may not be shown under a general denial of indebtedness. *Diemar & Kirk Co. v. Smart Styles, Inc.*, 261 N.C. 156, 134 S.E.2d 134 (1964).

**Failure of consideration is a valid defense to a note under seal** by reason of the fact the presumption arising from a seal upon a negotiable instrument is rebuttable. *Patterson v. Fuller*, 203 N.C. 788, 167 S.E. 74 (1933).

It is the general rule in this jurisdiction, and elsewhere, that a total failure of the consideration for a note under seal renders it unenforceable in the hands of any person other than a holder in due course. *Mills v. Bonin*, 239 N.C. 498, 80 S.E.2d 365 (1954).

**Since Presumption of Consideration May Be Rebutted.**—While the execution and de-

livery of a note under seal raises the presumption of consideration, such presumption, under the NIL, was rebuttable as against any person not a holder in due course. *Lentz v. Johnson & Sons*, 207 N.C. 614, 178 S.E. 226 (1935); *Mills v. Bonin*, 239 N.C. 498, 80 S.E.2d 365 (1954).

A note under seal creates a rebuttable presumption of consideration. *Wachovia Bank & Trust Co. v. Smith Crossroads, Inc.*, 258 N.C. 696, 129 S.E.2d 116 (1963).

**Where Holder Takes Subject to Equities.**—In *Planter's Bank v. Yelverton*, 185 N.C. 314, 117 S.E. 299 (1923), it is held that under the NIL, one taking without indorsement takes subject to equities between the original parties, and the presumption of consideration may be rebutted.

**Instrument Is Not Deemed Issued as Gift.**—A negotiable instrument is deemed prima facie to have been issued for a valuable consideration and not as a gift, unless the circumstances indicate otherwise. *Diemar & Kirk Co. v. Smart Styles, Inc.*, 261 N.C. 156, 134 S.E.2d 134 (1964).

**Burden of Proof.**—When plaintiff declared on a past-due negotiable note regular in form, and offered evidence of its execution by defendants, a prima facie case was made out, which imposed upon defendant the burden of going forward with evidence to rebut the presumption created by the NIL, or incur the risk of an adverse verdict. *Beam v. Wright*, 224 N.C. 677, 32 S.E.2d 213 (1944).

Where, between the original parties, the maker sets up the want of consideration for a note he has made to the payee as a defense, in an action thereon the burden is upon him to introduce evidence to establish his defense, and his failure to do so will entitle the payee to a judgment in his favor. *Merchants Nat'l Bank v. Andrews*, 179 N.C. 341, 102 S.E. 500 (1920). See also *Bank of Lewiston v. Harrington*, 205 N.C. 244, 170 S.E. 916 (1933).

Where there is evidence tending to show that the president of a bank had received from the defendant an exchange of notes for the former's benefit, and that the defendant in the bank's action on the note admits its execution and delivery, it is prima facie evidence that the note was given for a consideration and defendant must show failure of consideration when relied upon by him. *American Trust Co. v. Anagnos*, 196 N.C. 327, 145 S.E. 619 (1928).

While a valuable consideration is essential to the support of negotiable instruments, it is not necessary in an action upon them for the plaintiff to aver and prove such consideration; yet when evidence has been introduced by the defendant to rebut

the presumption which they raise, the burden is thrown upon the plaintiff to satisfy the jury by a preponderance of evidence

that there was a consideration. *Campbell v. McCormac*, 90 N.C. 491 (1884); *Hunt v. Eure*, 188 N.C. 716, 125 S.E. 484 (1924).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 24, 25 and 28. Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded.

**Purposes of changes:**

1. "Consideration" is distinguished from "value" throughout this Article. "Consideration" refers to what the obligor has received for his obligation, and is important only on the question of whether his obligation can be enforced against him.

2. The "except" clause is intended to remove the difficulties which have arisen where a note or a draft, or an indorsement of either, is given as payment or as security for a debt already owed by the party giving it, or by a third person. The provision is intended to change the result of decisions holding that where no extension of time or other concession is given by the creditor the new obligation fails for lack of legal consideration. It is intended also to mean that an instrument given for more or less than the amount of a liquidated obligation does not fail by reason of the common law rule that an obligation for a lesser liquidated amount cannot be consideration

for the surrender of a greater.

3. With respect to the necessity or sufficiency of consideration, other obligations on an instrument are subject to the ordinary rules of contract law relating to contracts not under seal. Promissory estoppel or any other equivalent or substitute for consideration is to be recognized as in other contract cases. The provision of the original Section 28 as to absence or failure of consideration is now covered by the section dealing with the rights of one not a holder in due course; and the "presumption" of consideration in the original Section 24 is replaced by the provision relating to the burden of establishing defenses.

**Cross references:**

Point 1: Section 3—303.

Point 3: Sections 3—306(c) and 3—307(2).

**Definitional cross references:**

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Person". Section 1—201.

"Rights". Section 1—201.

### NORTH CAROLINA COMMENT

As was true with the NIL, article 3 throughout makes a distinction between "consideration" and "value." "Consideration" is concerned with what the obligor has received, and it pertains to whether he has a defense. By contrast, "value" pertains to what a purchaser has given in order to be a taker for value; and, of course, value is an essential element for HDC status (GS 25-3-302 and 25-3-303).

The old rebuttable "presumption" of consideration in NIL 24 (GS 25-29) is dropped officially, but it is factually replaced by GS 25-3-307 which requires one who pleads a defense (e.g., want or failure of consideration) to "establish a defense," thus putting the burden on the party who pleads the defense.

Some prior North Carolina decisions appear to be inconsistent on the issue of who had the burden of proof on consideration or no consideration.

*Piner v. Brittain*, 165 N.C. 401, 81 S.E. 462 (1914), held, burden of showing failure of consideration is on maker of note. See also *Hunt v. Eure*, 188 N.C. 716, 125 S.E. 484 (1924), which states the contra rule for a nonnegotiable note (burden on plaintiff).

*Stein v. Levins*, 205 N.C. 302, 171 S.E. 96 (1933), seems to state that the burden of proving no consideration is on the plaintiff. (GS 25-3-307 is to the contrary.)

Briefly, this revised section makes no major change in North Carolina law.

**§ 25-3-409. Draft not an assignment.**—(1) A check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it.

(2) Nothing in this section shall affect any liability in contract, tort or otherwise arising from any letter of credit or other obligation or representation which is not an acceptance. (1899, c. 733, ss. 127, 189; Rev., ss. 2277, 2339; C. S., ss. 3109, 3171; 1965, c. 700, s. 1.)



**Payee Has No Right of Action against Bank until Acceptance.**—An action cannot be sustained against a bank by the payee of a negotiable check, though the drawer has funds on deposit sufficient for its payment against which the bank has no claim until after its acceptance by the bank. *Commercial Nat'l Bank v. First Nat'l Bank*, 118 N.C. 783, 24 S.E. 524 (1896). See also *Brantley v. Collie*, 205 N.C. 229, 171 S.E. 88 (1933); *Marx v. Maddrey*, 106 F. Supp. 535 (E.D.N.C. 1952).

**Acceptance may be evidenced in various ways**, as where the bank pays the check without indorsement to some person unauthorized by the payee to receive it and charges the amount to the depositor's account, and where evidence on this point is conflicting an issue is raised for the jury,

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 127 and 189, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; new provisions.

**Purposes of changes and new matter:**

The two original sections are combined, brought forward to appear in connection with acceptance, and reworded to remove uncertainties.

1. As under the original sections, a check or other draft does not of itself operate as an assignment in law or equity. The assignment may, however appear from other facts, and particularly from other agreements, express or implied; and when the intent to assign is clear the check may be the means by which the assignment is effected.

2. The language of the original Section 189, that the drawee is not liable "to the holder", is changed as inaccurate and not intended. The drawee is not liable on the instrument until he accepts; but he remains subject to any other liability to the holder. In this connection reference should be made to Section 4-302 on the payor bank's liability for late return. Such a bank if it does not either

and a judgment as of nonsuit should be denied. *Dawson v. National Bank*, 196 N.C. 134, 144 S.E. 833 (1928).

**Check Holder Held Assignee of Debt Due Depositor But without Lien on Deposit.**—A depositor is a creditor of a bank, his deposit becoming a part of the general fund, the property of the bank, and subject to assignment by the owners of the bank, and a check holder is, to the extent of his check, the assignee of the depositor's debt due him by the bank, but he has no lien upon the deposit for the amount of this check. A payee or holder of a check has an interest in the deposit as against the drawer, subject to the bank's right to pay outstanding checks before notice. *Hawes v. Blackwell*, 107 N.C. 196, 12 S.E. 245 (1890).

make prompt settlement or return on an item received by it will become liable to a holder of the item.

3. Subsection (2) is new. It is intended to make it clear that this section does not in any way affect any liability which may arise apart from the instrument itself. The drawee who fails to accept may be liable to the drawer or to the holder for breach of the terms of a letter of credit or any other agreement by which he is obligated to accept. He may be liable in tort or upon any other basis because of his representation that he has accepted, or that he intends to accept. The section leaves unaffected any liability of any kind apart from the instrument.

**Cross references:**

Sections 3-410, 3-411, 3-412 and 3-415.

Point 2: Section 4-302.

**Definitional cross references:**

"Acceptance". Section 3-410.

"Check". Section 3-104.

"Contract". Section 1-201.

"Draft". Section 3-104.

"Instrument". Section 3-102.

"Letter of credit". Section 5-104.

### NORTH CAROLINA COMMENT

This section is about the same as the prior law of GS 25-134 and 25-197. See 13 N.C.L. Rev. 131 and 31 N.C.L. Rev. 190 (1953) as to what orders constitute an assignment.

A number of North Carolina cases hold:

(1) That a check passes no title to money on deposit. *Perry v. Bank of Smithfield*, 131 N.C. 117, 42 S.E. 551 (1902);

(2) that payee of unaccepted, uncertified check has no right of action against bank. *General American Life Ins. Co. v. Stadiem*, 223 N.C. 49, 25 S.E.2d 202 (1943); and

(3) that drawer may stop payment before acceptance. In re *Will of Winborne*, 231 N.C. 463, 57 S.E.2d 795 (1950).

**§ 25-3-410. Definition and operation of acceptance.**—(1) Acceptance is the drawee's signed engagement to honor the drafts as presented. It must be

written on the draft, and may consist of his signature alone. It becomes operative when completed by delivery or notification.

(2) A draft may be accepted although it has not been signed by the drawer or is otherwise incomplete or is overdue or has been dishonored.

(3) Where the draft is payable at a fixed period after sight and the acceptor fails to date his acceptance the holder may complete it by supplying a date in good faith. (1899, c. 733, ss. 132 to 138, 161 to 170, 191; Rev., ss. 2282 to 2288, 2311 to 2320, 2340; C. S., ss. 2976, 3114 to 3120, 3143 to 3152; 1949, c. 954; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 132, 133, 134, 135, 136, 137, 138, 161—170, and 191, Uniform Negotiable Instruments Law.

**Changes:** Combined, reworded; original Sections 134, 135, 137 and 161—170 eliminated.

#### Purposes of changes:

1. The original Sections 161—170 providing for acceptance for honor are omitted from this Article. This ancient practice developed at a time when communications were slow, and particularly in overseas transactions there might be a delay of several months before the drawer could be notified of dishonor by nonacceptance and take steps to protect his credit. The need for intervention by a third party has passed with the development of the cable transfer, the letter of credit, and numerous other devices by which a substitute arrangement is promptly made. The practice has been obsolete for many years, and the sections are therefore eliminated.

2. Under Section 3—417 a person obtaining acceptance gives a warranty against alteration of the instrument before acceptance.

3. Subsection (1) adopts the rule of Section 17 of the English Bills of Exchange Act that the acceptance must be written on the draft. It eliminates the original Sections 134 and 135, providing for "virtual" acceptance by a written promise to accept drafts to be drawn, and "collateral" acceptance by a separate writing. Both have been anomalous exceptions to the policy that no person is liable on an instrument unless his signature appears on it. Both are derived from a line of early American cases decided at a time when difficulties of communication, particularly overseas, might leave the holder in doubt for a long period whether the draft was accepted. Such conditions have long since ceased to exist, and the "virtual" or "collateral" acceptance is now almost entirely obsolete. Good commercial and banking practice does not sanction acceptance by any separate writing because of the dangers

and uncertainties arising when it becomes separated from the draft. The instrument is now forwarded to the drawee for his acceptance upon it, or reliance is placed upon the obligation of the separate writing itself, as in the case of a letter of credit.

Nothing in this section is intended to eliminate any liability of the drawee in contract, tort or otherwise arising from the separate writing or any other obligation or representation, as provided in Section 3—409.

Subsection (1) likewise eliminates the original Section 137, providing for acceptance by delay or refusal to return the instrument but the drawee may be liable for a conversion of the instrument under Section 3—419.

4. Subsection (1) states the generally recognized rule that the mere signature of the drawee on the instrument is a sufficient acceptance. Customarily the signature is written vertically across the face of the instrument; but since the drawee has no reason to sign for any other purpose his signature in any other place, even on the back of the instrument, is sufficient. It need not be accompanied by such words as "Accepted," "Certified," or "Good." It must not, however, bear any words indicating an intent to refuse to honor the bill; and nothing in this provision is intended to change such decisions as *Norton v. Knapp*, 64 Iowa 112, 19 N.W. 867 (1884), holding that the drawee's signature accompanied by the words "Kiss my foot" is not an acceptance.

5. The final sentence of subsection (1) expressly states the generally recognized rule, implied in the definition of acceptance in the original Section 191, that an acceptance written on the draft takes effect when the drawee notifies the holder or gives notice according to his instructions. Acceptance is thus an exception to the usual rule that no obligation on an instrument is effective until delivery.

6. Subsection (3) changes the last sentence of the original Section 138. The

purpose of the provision is to provide a definite date of payment where none appears on the instrument. An undated acceptance of a draft payable "thirty days after sight" is incomplete; and unless the acceptor himself writes in a different date the holder is authorized to complete the acceptance according to the terms of the draft by supplying a date of presentment. Any date which the holder chooses to write in is effective providing his choice of date is made in good faith. Any different agreement not written on the draft is not effective, and parol evidence is not admissible to show it.

**Cross References:**

Sections 3—411, 3—412 and 3—418.

**NORTH CAROLINA COMMENT**

One big quantitative change is the elimination of the special rules governing the obsolete "acceptance for honor" in GS 25-168 to 25-177 (NIL 161-170). There have been no North Carolina decisions citing these sections in the more than sixty-five years of the NIL.

An important substantive change requires that all acceptances must be on the draft. Under GS 25-141 and 25-142 (NIL 134 and 135) an acceptance could be on a separate paper. See *Nimock v. Woody*, 97 N.C. 1, 2 S.E. 249 (1887), holding a separate writing to be an acceptance binding the acceptor; *Bank of Morganton v. Hay*, 143 N.C. 326, 55 S.E. 811 (1906), holding the particular separate writing did not contain a true acceptance. (Case mainly relates to authority of an agent to draw on his principal.)

Though an "acceptance" must be on the draft, the section is not intended to eliminate any liability of a drawee in contract, tort or otherwise arising from the separate writing or any other obligation or representation. (GS 25-3-409(2) also expressly states this).

Subsection (1) also eliminates the NIL 137 (GS 25-144) provision on constructive

Point 2: Section 3—417.

Point 3: Sections 3—401(1), 3—409(2) and 3—419.

Point 6: Section 3—412.

**Definitional cross references:**

"Delivery". Section 1—201.

"Dishonor". Section 3—507.

"Draft". Section 3—104.

"Good faith". Section 1—201.

"Holder". Section 1—201.

"Honor". Section 1—201.

"Notification". Section 1—201.

"Presentment". Section 3—504.

"Signature". Section 3—401.

"Signed". Section 1—201.

"Written". Section 1—201.

acceptance when the drawee destroys the instrument or refuses to return it within 24 hours after receipt. Under GS 25-3-419, however, the drawee may be liable for conversion.

*Note:* North Carolina had amended GS 25-144 (NIL 137) to include a provision permitting a bank to disaffirm some conditional payments until midnight the next day. See article 4 on bank deposits and collections.

See also *Branch Banking & Trust Co. v. Bank of Washington*, 255 N.C. 205, 120 S.E.2d 830 (1961), for a long 4-2 decision holding the bank of a drawee of a draft not liable as a constructive acceptor when bank delayed returning the dishonored draft (but bank might be liable in tort).

Subsection 3 permits a holder to supply an acceptance date in "good faith" when a draft is payable at a fixed period after sight. Though this technically changes the wording of the last sentence of NIL 138 (GS 25-145), the new good faith test will probably be applied by reference to the prior law of NIL 138 (GS 25-145) and NIL 136 GS 25-143).

**§ 25-3-411. Certification of a check.**—(1) Certification of a check is acceptance. Where a holder procures certification the drawer and all prior indorsers are discharged.

(2) Unless otherwise agreed a bank has no obligation to certify a check.

(3) A bank may certify a check before returning it for lack of proper indorsement. If it does so the drawer is discharged. (1899, c. 733, ss. 187, 188; Rev., ss. 2337, 2338; C. S., ss. 3169, 3170; 1965, c. 700, s. 1.)

**Certification Is Acceptance.**—The certification of a check by the bank on which it is drawn is equivalent to the acceptance, and the bank then becomes the debtor to the holder, against whom he may maintain his action. *Drewry-Hughes Co. v. Davis*, 151 N.C. 295, 66 S.E. 139 (1909).

**It Does Not Affect Agreement between Maker and Payee.**—Certification of a check does not affect the enforcement of an agreement between the original parties, made before the certification, by which the debtor had agreed to waive or withdraw a condition annexed to the acceptance of his



check by the payee that it was to be received by the payee, his creditor, in full compromise of his debt in a larger amount.

*Drewry-Hughes Co. v. Davis*, 151 N.C. 295, 66 S.E. 139 (1909).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 187 and 188, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; new provisions.

**Purposes of changes and new matter:**

1. The second sentence of subsection (1) continues the rule of original Section 188 that, while certification procured by a holder discharges the drawer and other prior parties, certification procured by the drawer leaves him liable. Under this provision any certification procured by a holder discharges the drawer and prior indorsers. Any indorsement made after a certification so procured remains effective; and where it is intended that any indorser shall remain liable notwithstanding certification, he may indorse with the words "after certification" to make his liability clear.

2. Subsection (2) is new. It states the generally recognized rule that in the absence of agreement a bank is under no obligation to certify a check, because it is a demand instrument calling for payment rather than acceptance. The bank may be liable for breach of any agree-

ment with the drawer, the holder, or any other person by which it undertakes to certify. Its liability is not on the instrument, since the drawee is not so liable until acceptance (Section 3—409(1)). Any liability is for breach of the separate agreement.

3. Subsection (3) is new. It recognizes the banking practice of certifying a check which is returned for proper indorsement in order to protect the drawer against a longer contingent liability. It is consistent with the provision of Section 3—410(2) permitting certification although the check has not been signed or is otherwise incomplete.

#### Cross references:

Sections 3—412, 3—413, 3—417 and 3—418.

Point 2: Section 3—409(1).

Point 3: Section 3—410(2).

#### Definitional cross references:

"Acceptance". Section 3—410.

"Bank". Section 1—201.

"Check". Section 3—104.

"Holder". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1)* continues the rule of GS 25-196 (NIL 188) that certification by a drawer leaves him liable as a secondary party, while certification by a holder discharges the drawer and other prior parties. *Commercial Inv. Trust v. Windsor*, 197 N.C. 208, 148 S.E. 42 (1929), is to the same effect.

*Subsections (2) and (3)* are new and are self-explanatory. See also Official Comments 2 and 3.

There is no real change from North Carolina law.

**§ 25-3-412. Acceptance varying draft.**—(1) Where the drawee's proffered acceptance in any manner varies the draft as presented the holder may refuse the acceptance and treat the draft as dishonored in which case the drawee is entitled to have his acceptance cancelled.

(2) The terms of the draft are not varied by an acceptance to pay at any particular bank or place in the United States, unless the acceptance states that the draft is to be paid only at such bank or place.

(3) Where the holder assents to an acceptance varying the terms of the draft each drawer and indorser who does not affirmatively assent is discharged. (1899, c. 733, ss. 139 to 142; Rev., ss. 2289 to 2292; C. S., ss. 3121 to 3124; 1965, c. 700, s. 1.)

**Acceptance Qualified as to Time.**—Where one accepted a draft on him "payable when I receive funds to the use of the drawer," he became liable when the

moneys were placed to his credit though he had not taken manual possession thereof. *Wallace Bros. v. Douglas*, 116 N.C. 659, 21 S.E. 387 (1895).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 139, 140, 141 and 142, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; law changed as to qualified acceptances.

**Purposes of Changes:**

1. The section applies to conditional acceptances, acceptances for part of the amount, acceptances to pay at a different time from that required by the draft, or to the acceptance of less than all of the drawees, all of which are covered by the original Section 141. It applies to any other engagement changing the essential terms of the draft.

2. Where the drawee offers such a varied engagement the holder has an election. He may reject the offer, insist on acceptance of the draft as presented, and treat the refusal to give it as a dishonor. In that event the drawee is not bound by his engagement, and is entitled to have it cancelled. After any necessary notice of dishonor and protest the holder may have his recourse against the drawer and indorsers.

If the holder elects to accept the offer, this section does not invalidate the drawee's varied engagement. It remains his effective obligation, which the holder may enforce against him. By his assent, however, the holder discharges any drawer

or indorser who does not also assent. The rule of the original Section 142 is changed to require that the assent of the drawer or indorser be affirmatively expressed. Mere failure to object within a reasonable time is not assent which will prevent the discharge.

3. The rule of original Section 140 that an acceptance to pay at a particular place is an unqualified acceptance is modified by the provision of subsection (2) that the terms of the draft are not varied by an acceptance to pay at any particular bank or place in the United States unless the acceptance states that the draft is to be paid only at such bank or place. Section 3-504(4) provides that a draft accepted payable at a bank in the United States must be presented at the bank designated.

**Cross references:**

Sections 3-410 and 3-413.

Point 3: Section 3-504(4).

**Definitional cross references:**

"Acceptance". Section 3-410.

"Bank". Section 1-201.

"Dishonor". Section 3-507.

"Draft". Section 3-104.

"Holder". Section 1-201.

"Term". Section 1-201.

"Written". Section 1-201.

## NORTH CAROLINA COMMENT

This section combines and rewords GS 25-146 to GS 25-149 (NIL 139-142) and makes a change in the effect of the acceptance of a varying acceptance on the liability of a secondary party. The change relates to implied consent by the secondary party to the taking of a varying acceptance.

Under prior law (GS 25-149) a secondary party was not discharged when the holder took a varying acceptance if the secondary party either expressly or impliedly consented to such acceptance before or after the acceptance. Also, a subsequent assent was implied when a secondary party did not express his dissent to a varying acceptance within a reason-

able time after he received notice of it. Thus, the secondary party who wished to be discharged because of a varying acceptance had to take action to show his disapproval of the varying acceptance.

Contrary to the prior law of GS 25-149, this UCC section does not recognize an implied assent of a secondary party merely because of his failure to object within a reasonable time. See Official Comment 2. Furthermore, the new section apparently will not recognize any implied advance consent or any implied subsequent assent to a varying acceptance. See subsection (3) which states: "... each drawer and indorser who does not affirmatively assent is discharged."

**§ 25-3-413. Contract of maker, drawer and acceptor.**—(1) The maker or acceptor engages that he will pay the instrument according to its tenor at the time of his engagement or as completed pursuant to § 25-3-115 on incomplete instruments.

(2) The drawer engages that upon dishonor of the draft and any necessary notice of dishonor or protest he will pay the amount of the draft to the holder or to any indorser who takes it up. The drawer may disclaim this liability by drawing without recourse.

(3) By making, drawing or accepting the party admits as against all subsequent

parties including the drawee the existence of the payee and his then capacity to indorse. (1899, c. 733, ss. 60 to 62; Rev., ss. 2209 to 2211; C. S., ss. 3041 to 3043; 1965, c. 700, s. 1.)

**Drawer May Arrest Payment.** — A drawer of a draft, ordinarily standing towards subsequent parties as a general indorser, may, by appropriate words appearing on the paper, or by agreement dehors the instrument as to persons affected with notice, retain the right to arrest payment. *Murchison Nat'l Bank v. Dunn Oil Mills Co.*, 150 N.C. 718, 64 S.E. 885 (1909).

**As May Restrictive Indorser.**—Where a draft or bill is transferred to a bank by restrictive indorsement, as for deposit or for collection, the instrument is taken and held by the bank as agent for the indorser, and for the purpose indicated, and subject to the right of the indorser to arrest payment or divert the proceeds in the hands of any intermediate or subagent who has taken the paper for like purpose and affected by the restriction. *Murchison Nat'l Bank v. Dunn Oil Mills Co.*, 150 N.C. 718, 64 S.E. 885 (1909).

**Except as to Holder without Notice of Restrictions.**—When a bank to which a draft, appearing on its face to be negotiable, is forwarded by another bank, purchases it for value, without notice of an agreement restricting its negotiation, the drawer may not stop payment of the draft as against the rights of the bank so holding the paper. *Murchison Nat'l Bank v. Dunn Oil Mills Co.*, 150 N.C. 718, 64 S.E. 885 (1909).

**When Liability of Drawee Accrues.**—Until the instrument is accepted, the payee or holder of the bill must look to the drawer for his protection. The liability of

the drawee to the payee or holder accrues when he makes a valid acceptance of the bill and when it is in the possession or is delivered to one who is entitled to enforce the engagement contained in the acceptance. The legal intentment of the acceptance is that the acceptor engages to pay the instrument according, but only according, to the tenor of his acceptance. It is, in short, a promise to pay. *Branch Banking & Trust Co. v. Bank of Washington*, 255 N.C. 205, 120 S.E.2d 830 (1961).

**Burden on Acceptor to Prove Signature of Drawer.**—When a check drawn against a depositor of a bank is paid by the bank, in an action to recover deposits, the burden is on the bank to show that the check was signed by the depositor as maker. *Yarborough v. Banking Loan & Trust Co.*, 142 N.C. 377, 55 S.E. 296 (1906).

**Drawee Bank Cannot Recover Amount Paid on Forged Check.**—Where the cashing bank acts in good faith, the drawee cannot recover the amount which it has paid on a forged check. The drawee should know the signature of the drawer, its own depositor, better than the holder. The drawee cannot plead a custom that would entitle it to pay such draft without the signature being genuine. The fact that the cashing bank stamped the check "all prior indorsements guaranteed" makes no difference to the drawee as that guarantee is only applicable to subsequent holders in due course. *State Bank v. Cumberland Savings & Trust Co.*, 168 N.C. 605, 85 S.E. 5 (1915).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 60, 61 and 62, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded.

**Purposes of changes:**

The original sections are combined for convenience and condensed to avoid duplication of language. This section should be read in connection with the sections on incomplete instruments (3—115), negligence contributing to alteration or unauthorized signature (3—406), alteration (3—407), acceptances varying a draft (3—412) and finality of payment or acceptance (3—418). Thus a maker who signs an incomplete note engages under this section to pay it according to its tenor at the time he signs it, but by vir-

tue of Sections 3—115 and 3—407 the note may thereafter be completed and enforced against him. In the same way, if the maker's negligence substantially contributes to alteration of the instrument, he will become liable on his note as altered under Section 3—406. When a holder assents to an acceptance varying a draft (Section 3—412) he can of course hold the acceptor only according to the form of acceptance to which the holder agreed. Section 3—418 applies the rule of *Price v. Neal* both to acceptance and payment; thus an acceptor may not, after acceptance, assert that the drawer's signature is unauthorized.

Subsection (1) applies to all drafts (including checks) the rule that the accept-



ance relates to the instrument as it was at the time of its acceptance and not (in case of alteration before acceptance) to its original tenor. The cases on this point under the original act (all of which involved checks) have been in conflict. It should be noted that under Section 3-417 a person who obtains acceptance warrants to the acceptor that the instrument has not been materially altered.

Except as indicated in the foregoing comment the section makes no change in substance from the provision of the original Act.

#### NORTH CAROLINA COMMENT

The section makes no real change in substance. The section, however, must be read in conjunction with:

GS 25-3-115—Incomplete instruments.

GS 25-3-406—Negligence contributing to alteration or unauthorized signature.

#### Cross references:

Sections 3-115, 3-406, 3-407, 3-412, 3-417 and 3-418.

#### Definitional cross references:

"Contract". Section 1-201.

"Dishonor". Section 3-507.

"Draft". Section 3-104.

"Holder". Section 1-201.

"Instrument". Section 3-102.

"Notice of dishonor". Section 3-508.

"Party". Section 1-201.

"Protest". Section 3-509.

GS 25-3-407—Alteration.

GS 25-3-412—Acceptance varying draft.

GS 25-3-418—Finality of payment or acceptance.

**§ 25-3-414. Contract of indorser; order of liability.**—(1) Unless the indorsement otherwise specifies (as by such words as "without recourse") every indorser engages that upon dishonor and any necessary notice of dishonor and protest he will pay the instrument according to its tenor at the time of his indorsement to the holder or to any subsequent indorser who takes it up, even though the indorser who takes it up was not obligated to do so.

(2) Unless they otherwise agree indorsers are liable to one another in the order in which they indorse, which is presumed to be the order in which their signatures appear on the instrument. (1899, c. 733, ss. 38, 44, 66 to 68; Rev., ss. 2187, 2193, 2215 to 2217; C. S., ss. 3019, 3025, 3047 to 3049; 1965, c. 700, s. 1.)

**Cross Reference.**—As to warranties on transfer, § 25-3-417.

**Contract of Indorsement Is Separate Contract.**—A contract of indorsement is a substantive contract, separable and independent of the instrument on which it appears, and under the NIL, where it was made without qualification and for value it guaranteed to a holder in due course among other things that the instrument, at the time of the indorsement, was a valid and subsisting obligation. *Wachovia Bank & Trust Co. v. Crafton*, 181 N.C. 404, 107 S.E. 316 (1921).

**Which Cannot Be Explained by Parol Except between Original Parties.**—When a payee or regular indorsee thereof writes his name on the back of a note, as between him and a bona fide holder for value and without notice, the law implies that he intended to assume the well-known liability of an indorser, and he will not be permitted to contradict this implication. But this rule does not apply between the original parties to a contract which is not in writing, although there may be the signature of one or more parties to authenticate that some contract was made. *Sykes v. Everett*, 167 N.C. 600, 83 S.E. 585 (1914).

In an action upon a note by a remote indorsee, who purchased bona fide for full value and without notice, against the payee, who indorsed the note in blank, evidence of an agreement between the payee and his immediate indorsee that he should not be held liable on his indorsement is not admissible. *Hill v. Shields*, 81 N.C. 250 (1879).

Parol evidence is admissible to show that as between or among themselves parties to a negotiable instrument are liable otherwise than appears prima facie. *Citizens Nat'l Bank v. Burch*, 145 N.C. 316, 59 S.E. 71 (1907); *Sykes v. Everett*, 167 N.C. 600, 83 S.E. 585 (1914); *Gillam v. Walker*, 189 N.C. 189, 126 S.E. 424 (1925); *Dillard v. Farmers' Mercantile Co.*, 190 N.C. 225, 129 S.E. 598 (1925); *Lancaster v. Stanfield*, 191 N.C. 340, 132 S.E. 21 (1926).

**But Parol Evidence of Agreement to Pay from Particular Fund Is Admissible.**—Where an unqualified indorsement is supported by a valuable consideration and the maker seeks to enforce the indorser's liability, the indorser may introduce parol evidence of an agreement entered into by the parties contemporaneously with the execution of the note that payment was

to be made out of a particular fund, but he may not introduce parol evidence in contradiction of the written terms of the note that he was not to be held liable in any event. *Kindler v. Wachovia Bank & Trust Co.*, 204 N.C. 198, 167 S.E. 811 (1933).

**Substituted Indorser Is Liable as General Indorser.**—Where an indorser as originally appearing on a negotiable note has his name stricken from the instrument by the payee and another person signs in substitution for him, the liability of the substituted indorser to the payee remains as a general indorser, unaffected by the cancellation and substitution, when his signature is not obtained by misrepresentation that the other indorsers had consented to the substitution and remained bound by the instrument. *Efrd v. Little*, 205 N.C. 583, 172 S.E. 198 (1934).

**Indorsement after Maturity.**—An indorsee taking after maturity took the title to whatever interest his indorser had, and by the indorsement the indorser made such warranties as were provided by the NIL. *Smith v. Godwin*, 145 N.C. 242, 58 S.E. 1089 (1907).

**Effect of Indorsement without Recourse.**—Where notes were indorsed by the payee named therein, who wrote above his signature on the back of each note the words "without recourse," under the NIL this was a qualified indorsement. Its effect was to constitute the indorser a mere assignor of the title to the note, which he held at the date of the indorsement. It did not impair the negotiable character of the note so indorsed. *Evans v. Freeman*, 142 N.C. 61, 54 S.E. 847 (1906); *Bank of Sampson v. Hatcher*, 151 N.C. 359, 66 S.E. 308 (1909); *Walter v. Kilpatrick*, 191 N.C. 458, 132 S.E. 148 (1926).

Alone, a qualified indorsement was not

sufficient notice as to discredit a negotiable instrument under the NIL, but when combined with other suspicious facts it might become evidence to show infirmities. *Merchants Nat'l Bank v. Branson*, 165 N.C. 344, 81 S.E. 410 (1914).

An indorsement "without recourse" under the NIL did not impair the negotiability of the instrument, but qualified the indorsement, and where one had acquired a negotiable instrument by an indorsement by a holder without recourse, there was no implied warranty on the part of such indorser. *Evans v. Freeman*, 142 N.C. 61, 54 S.E. 847 (1906); *Walter v. Kilpatrick*, 191 N.C. 458, 132 S.E. 148 (1926).

**Set-Off of Deposit against Note.**—Where a depositor in an insolvent national bank had indorsed a note on which he was in fact primarily liable, and procured the bank to discount it for his benefit, he was entitled in a suit by the bank's receiver to recover the amount of the note, to set off his deposit in the bank against his liability on the note. *Williams v. Coleman*, 190 N.C. 368, 129 S.E. 818 (1925).

**Contribution among Indorsers.**—An indorser of a negotiable instrument is not subject to contribution among all others who may have indorsed the same, but only liable to those who are subsequent in date to his indorsement, to the full amount of their payment as an indemnitor. *Lancaster v. Stanfield*, 191 N.C. 340, 132 S.E. 21 (1926).

An indorser of a negotiable instrument who had paid a judgment obtained thereon in an action against him and the insolvent makers, cannot, nothing else appearing, recover the amount in his action therefor against a subsequent indorser. *Lynch v. Loftin*, 153 N.C. 270, 69 S.E. 143 (1910).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 38, 44, 66, 67 and 68, Uniform Negotiable Instruments Law.

**Changes:** Combined and rewrote.

**Purposes of changes:**

1. Subsection (1) states the contract of indorsement—that if the instrument is dishonored and any protest or notice of dishonor which may be necessary under Section 3—501 is given, the indorser will pay the instrument. The indorser's engagement runs to any holder (whether or not for value) and to any indorser subsequent to him who has taken the instrument up. An indorser may disclaim his liability on the contract of indorsement, but only if the indorsement itself so specifies. Since the disclaimer varies the

written contract of indorsement, the disclaimer itself must be written on the instrument and cannot be proved by parol. The customary manner of disclaiming the indorser's liability under this section is to indorse "without recourse". Apart from such a disclaimer all indorsers incur this liability, without regard to whether or not the indorser transferred the instrument for value or received consideration for his indorsement.

Original Section 44, permitting a representative to indorse in such terms as to exclude personal liability, is omitted as unnecessary and included in the broader right to disclaim any liability. No change in the law is intended by this omission.

2. In addition to his liability on the

contract of indorsement, an indorser, if a transferor, gives the warranties stated in Section 3—417.

3. As in the case of acceptor's liability (Section 3—413), this section conditions the indorser's liability on the tenor of the instrument at the time of his indorsement. Thus if a person indorses an altered instrument he assumes liability as indorser on the instrument as altered.

4. Subsection (2) is intended to clarify existing law under original Section 68.

The section states two presumptions: One is that the indorsers are liable to one another in the order in which they have in fact indorsed. The other is that they have in fact indorsed in the order in which their names appear. Parol evidence is admissible to show that they have indorsed in another order, or that they have

otherwise agreed as to their liability to one another.

The last sentence of the original Section 68 is now covered by Section 3—118(e) (Ambiguous terms and rules of construction).

**Cross references:**

Point 1: Section 3—501.

Point 2: Section 3—417.

Point 3: Section 3—413.

Point 4: Section 3—118(e).

**Definitional cross references:**

"Contract". Section 1—201.

"Dishonor". Section 3—507.

"Holder". Section 1—201.

"Instrument". Section 3—102.

"Notice of dishonor". Section 3—508.

"Presumed". Section 1—201.

"Protest". Section 3—509.

"Signature". Section 3—401.

**NORTH CAROLINA COMMENT**

*Subsection (1):* As stated, the "contract" of an indorser is to "pay" the instrument if there is a dishonor and if any necessary notice and protest are properly made.

This "contract" applies to any indorser whether or not he is also a transferor. The additional liability of a transferor is covered by GS 25-3-417, covering "warranties on presentment and transfer."

A transferor-indorser may eliminate his "contract" to "pay" by indorsing "without recourse" (or by otherwise indicating that he does not make a contract to pay). However, the transferor-indorser will still be liable for any breach of the implied "warranties on presentment or transfer" (GS 25-3-417).

Generally, the restated rules are the

same as given in *Medlin v. Miles*, 201 N.C. 683, 161 S.E. 207 (1931) which held: (1) A qualified indorser is still liable on his warranties as a seller; (2) the words "without recourse" or similar qualifying words may precede or follow the signature of the transferor; (3) the words "I hereby sell, transfer and assign all my right, title and interest" are to be treated as a "qualified indorsement."

*Subsection (2):* This continues the rule of GS 25-74 (NIL 68) that indorsers are presumed to be liable in the order in which their signatures appear on the instrument. However, parol evidence is admissible to show the true order of indorsement.

**§ 25-3-415. Contract of accommodation party.**—(1) An accommodation party is one who signs the instrument in any capacity for the purpose of lending his name to another party to it.

(2) When the instrument has been taken for value before it is due the accommodation party is liable in the capacity in which he has signed even though the taker knows of the accommodation.

(3) As against a holder in due course and without notice of the accommodation oral proof of the accommodation is not admissible to give the accommodation party the benefit of discharges dependent on his character as such. In other cases the accommodation character may be shown by oral proof.

(4) An indorsement which shows that it is not in the chain of title is notice of its accommodation character.

(5) An accommodation party is not liable to the party accommodated, and if he pays the instrument has a right of recourse on the instrument against such party. (1899, c. 733, ss. 28, 29, 64; Rev., ss. 2176, 2177, 2213; C. S., ss. 3008, 3009, 3045; 1965, c. 700, s. 1.)

**Failure of Maker to Conform to Agreement.**—An accommodation indorser is not relieved from liability upon the ground that the maker agreed in parol to negoti-

ate the note at a certain bank which he failed to do, but negotiated to the plaintiff instead who had notice of the agreement. *Parker v. McDowell*, 95 N.C. 219 (1886);



Parker v. Sutton, 103 N.C. 191, 9 S.E. 283 (1889).

**Liability of Accommodation Indorser to Maker's Firm.**—A note executed by a member of a partnership to a third party who, as surety and for the accommodation of the maker, indorses it and receives no benefit from it, cannot be the subject of an action at law against the indorser by the firm, nor in case of the death of the maker of the note can the surviving partner maintain an action on the note against the accommodation indorser unless the firm be insolvent. Patton v. Carr, 117 N.C. 176, 23 S.E. 182 (1895).

**Order of Liability on Instrument.**—A note, indorsed for the maker's accommo-

dation, signed by the principal and surety, is a joint and several obligation, and the owner may sue all or either of the obligors, without joining all as defendants. Norfolk Nat'l Bank v. Griffin, 107 N.C. 173, 11 S.E. 1049 (1890); Bank v. Carr, 121 N.C. 113, 28 S.E. 186 (1897).

**Parol Evidence as to Character of Signing.**—As between the payee of a negotiable note and the signers thereof, a person signing his name on the face of the note may prove by parol evidence that to the knowledge of the payee he signed the same as surety and not maker. Davis v. Alexander, 207 N.C. 417, 177 S.E. 417 (1934).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 28, 29 and 64, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; new provisions.

**Purposes of changes and new matter:** To make it clear that:

1. Subsection (1) recognizes that an accommodation party is always a surety (which includes a guarantor), and it is his only distinguishing feature. He differs from other sureties only in that his liability is on the instrument and he is a surety for another party to it. His obligation is therefore determined by the capacity in which he signs. An accommodation maker or acceptor is bound on the instrument without any resort to his principal, while an accommodation indorser may be liable only after presentment, notice of dishonor and protest. The subsection recognizes the defenses of a surety in accordance with the provisions subjecting one not a holder in due course to all simple contract defenses, as well as his rights against his principal after payment. Under subsection (3) except as against a holder in due course without notice of the accommodation, parol evidence is admissible to prove that the party has signed for accommodation. In any case, however, under subsection (4) an indorsement which is not in the chain of title (the irregular or anomalous indorsement) is notice to all subsequent takers of the instrument of the accommodation character of the indorsement.

2. Subsection (1) eliminates the language of the old Section 29 requiring that the accommodation party sign the instrument "without receiving value therefor." The essential characteristic is that the accommodation party is a surety, and not that he has signed gratuitously. He may be

a paid surety, or receive other compensation from the party accommodated. He may even receive it from the payee, as where A and B buy goods and it is understood that A is to pay for all of them and that B is to sign a note only as a surety for A.

3. The obligation of the accommodation party is supported by any consideration for which the instrument is taken before it is due. Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accommodation party signs a note after it is in the hands of a holder who has given value. The party is liable to the holder in such a case even though there is no extension of time or other concession. This is consistent with the provision as to antecedent obligations as consideration (Section 3—408). The limitation to "before it is due" is one of suretyship law, by which the obligation of the surety is terminated at the time limit unless in the meantime the obligation of the principal has become effective.

4. As a surety the accommodation party is not liable to the party accommodated; but he is otherwise liable on the instrument in the capacity in which he has signed. This general statement of the rule makes unnecessary the detailed provisions of the original Section 64, which is therefore eliminated, without any change in substance.

5. Subsection (5) is intended to change the result of such decisions as *Quimby v. Varnum*, 190 Mass. 211, 76 N.E. 671 (1906), which held that an accommodation indorser who paid the instrument could not maintain an action on it against the accommodated party since he had no "former rights" to which he was remitted. Under ordinary principles of suretyship

the accommodation party who pays is subrogated to the rights of the holder paid, and should have his recourse on the instrument.

**Cross references:**

Sections 3—305, 3—408, 3—603, 3—604 and 3—606.

Point 1: Section 3—306(b).

Point 3: Section 3—408.

**Definitional cross references:**

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Notice". Section 1—201.

"Party". Section 1—201.

"Presentment". Section 3—504.

"Signed". Section 1—201.

"Writing". Section 1—201.

**NORTH CAROLINA COMMENT**

Basically, this section adopts the rules of GS 25-34 and 25-70 regarding the liability of an accommodation party. The section is probably about in line with better North Carolina decisions.

*Note:* New York has added a sixth par-

agraph to cover the warranties of an accommodation party; but the Permanent Editorial Board has rejected this amendment. See Report No. 1 of the Permanent Editorial Board for the UCC 75 (1962).

§ 25-3-416. **Contract of guarantor.**—(1) "Payment guaranteed" or equivalent words added to a signature mean that the signer engages that if the instrument is not paid when due he will pay it according to its tenor without resort by the holder to any other party.

(2) "Collection guaranteed" or equivalent words added to a signature mean that the signer engages that if the instrument is not paid when due he will pay it according to its tenor, but only after the holder has reduced his claim against the maker or acceptor to judgment and execution has been returned unsatisfied, or after the maker or acceptor has become insolvent or it is otherwise apparent that it is useless to proceed against him.

(3) Words of guaranty which do not otherwise specify guarantee payment.

(4) No words of guaranty added to the signature of a sole maker or acceptor affect his liability on the instrument. Such words added to the signature of one of two or more makers or acceptors create a presumption that the signature is for the accommodation of the others.

(5) When words of guaranty are used presentment, notice of dishonor and protest are not necessary to charge the user.

(6) Any guaranty written on the instrument is enforceable notwithstanding any statute of frauds. (1965, c. 700, s. 1.)

**Effect of Indorsement Enlarging Liability.**—"Demand, notice and protest waived, payment guaranteed by the undersigned" is an indorsement with an enlarged liability. The language makes the holder one in due course and the instrument is taken free from equities and defenses which the maker has against the payee. *Richmond Guano Co. v. Walston*, 191 N.C. 797, 133 S.E. 196 (1926).

**Effect of Guaranteeing Prior Indorsements.**—A certificate of deposit forwarded to another bank by the drawer bank must be presented in a reasonable time, and if not presented the drawer is not liable, although it stamped the certificate "Prior indorsements guaranteed." *Bank of Mount Airy v. Greensboro Loan & Trust Co.*, 159 N.C. 85, 74 S.E. 747 (1912).

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:** The section is new. It states the commercial understanding as to the meaning and effect of words of guaranty added to a signature.

An indorser who guarantees payment waives not only presentment, notice of dishonor and protest, but also all demand upon the maker or drawee. Words of guaranty do not affect the character of the indorsement as an indorsement (Section 3—202 (4)); but the liability of the

indorser becomes indistinguishable from that of a co-maker. A guaranty of collection likewise waives formal presentment, notice of dishonor and protest, but requires that the holder first proceed against the maker or acceptor by suit and execution, or show that such proceeding would be useless.

Subsection (6) is concerned chiefly with the type of statute of frauds which provides that no promise to answer for the debt, default or miscarriage of another

is enforceable unless it is evidenced by a writing which states the consideration for the promise. It is unusual to state any consideration when a guaranty is added to a signature on a negotiable instrument, which in itself sufficiently shows the nature of the transaction; and such statutes have commonly been held not to apply to such guaranties.

**Cross references:**

Sections 3—202(4) and 3—415.

**Definitional cross references:**

“Holder”. Section 1—201.

“Insolvent”. Section 1—201.

“Instrument”. Section 3—102.

“Notice of dishonor”. Section 3—508.

“Party”. Section 1—201.

“Presumption”. Section 1—201.

“Protest”. Section 3—509.

“Signature”. Section 3—401.

“Written”. Section 1—201.

**NORTH CAROLINA COMMENT**

This new section states the commercial effect of words of guaranty added to a signature. A guarantor is immediately liable upon default, and the holder need not resort to any other party.

This may change *Rouse v. Wooten*, 140 N.C. 557, 53 S.E. 430 (1906), and *Dry v. Reynolds*, 205 N.C. 571, 172 S.E. 351 (1934), on the issue of whether presentment for payment is necessary to charge a “surety” or a “guarantor.”

Cf. *Arcady Farms Milling Co. v. Wal-*

*lace*, 242 N.C. 686, 89 S.E.2d 413 (1955), holding that procedurally a guarantor on a separate letter may be joined as party defendant with principal debtor.

See also GS 25-3-502 on discharge when timely presentment not made.

It would seem that this section should not be construed to supersede the provisions of GS 26-7 permitting a guarantor to notify a creditor to take action against the principal with diligence.

**§ 25-3-417. Warranties on presentment and transfer.**—(1) Any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts that

(a) he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title; and

(b) he has no knowledge that the signature of the maker or drawer is unauthorized, except that this warranty is not given by a holder in due course acting in good faith

(i) to a maker with respect to the maker’s own signature; or

(ii) to a drawer with respect to the drawer’s own signature, whether or not the drawer is also the drawee; or

(iii) to an acceptor of a draft if the holder in due course took the draft after the acceptance or obtained the acceptance without knowledge that the drawer’s signature was unauthorized; and

(c) the instrument has not been materially altered, except that this warranty is not given by a holder in due course acting in good faith

(i) to the maker of a note; or

(ii) to the drawer of a draft whether or not the drawer is also the drawee; or

(iii) to the acceptor of a draft with respect to an alteration made prior to the acceptance if the holder in due course took the draft after the acceptance, even though the acceptance provided “payable as originally drawn” or equivalent terms; or

(iv) to the acceptor of a draft with respect to an alteration made after the acceptance.

(2) Any person who transfers an instrument and receives consideration warrants to his transferee and if the transfer is by indorsement to any subsequent holder who takes the instrument in good faith that

(a) he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title and the transfer is otherwise rightful; and

(b) all signatures are genuine or authorized; and

(c) the instrument has not been materially altered; and

(d) no defense of any party is good against him; and



(e) he has no knowledge of any insolvency proceeding instituted with respect to the maker or acceptor or the drawer of an unaccepted instrument.

(3) By transferring "without recourse" the transferor limits the obligation stated in subsection (2) (d) to a warranty that he has no knowledge of such a defense.

(4) A selling agent or broker who does not disclose the fact that he is acting only as such gives the warranties provided in this section, but if he makes such disclosure warrants only his good faith and authority. (1899, c. 733, ss. 65, 69; Rev., ss. 2214, 2218; C. S., ss. 3046, 3050; 1965, c. 700, s. 1.)

**Cross Reference.**—See note to § 25-3-414.

**Not Applicable to Usury.**—The provisions of the NIL made as to warranties which prevailed in case of unqualified in-

dorsements referred to lawful transactions, and did not relate to transactions coming within the meaning of the usury laws. *Sedbury v. Duffy*, 158 N.C. 432, 74 S.E. 355 (1912).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 65 and 69, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded; new provisions added.

**Purposes of changes and new matter:**

1. The obligations imposed by this section are stated in terms of warranty. Warranty terms, which are not limited to sale transactions, are used with the intention of bringing in all the usual rules of law applicable to warranties, and in particular the necessity of reliance in good faith and the availability of all remedies for breach of warranty, such as rescission of the transaction or an action for damages. Like other warranties, those stated in this section may be disclaimed by agreement between the immediate parties. In the case of an indorser, disclaimer of his liability as a transferor, to be effective, must appear in the form of the indorsement, and no parol proof of "agreement otherwise" is admissible. For corresponding warranties in the case of items in the bank collection process, Section 4—207 should be consulted.

2. Subsection (1) is new. It is intended to state the undertaking to a party who accepts or pays of one who obtains payment or acceptance or of any prior transferor. It is closely connected with the following section on the finality of acceptance or payment (Section 3—418), and should be read together with it.

3. Subsection (1) (a) retains the generally accepted rule that the party who accepts or pays does not "admit" the genuineness of indorsements, and may recover from the person presenting the instrument when they turn out to be forged. The justification for the distinction between forgery of the signature of the drawer and forgery of an indorsement is that the drawee is in a position to verify the drawer's signature by comparison

with one in his hands, but has ordinarily no opportunity to verify an indorsement.

4. Subsection (1) (b) recognizes and deals with competing equities of parties accepting or paying instruments bearing unauthorized maker's or drawer's signatures and those obtaining acceptances or receiving payment. The warranties prescribed and exceptions thereto follow closely principles established at common law, particularly, those under *Price v. Neal*, 3 Burr. 1354 (1762).

The basic warranty that the person obtaining payment or acceptance and any prior transferor warrants that he has no knowledge that the signature of the maker or drawer is unauthorized stems from the general principle that one who presents an instrument knowing that the signature of the maker or drawer is forged or unauthorized commits an obvious fraud upon the party to whom presentment is made. However, few cases present this simple fact situation. If the signature of a maker or drawer has been forged, the parties include the dishonest forger himself and usually one or more innocent holders taking from him. Frequently, the state of knowledge of a holder is difficult to determine and sometimes a holder takes such a forged instrument in perfect good faith but subsequently learns of the forgery. Since in different fact situations holders have equities of varying strength, it is necessary to have some exceptions to the basic warranty.

The exceptions apply only in favor of a holder in due course and, within the provisions of Section 3—201, to all subsequent transferees from a holder in due course. Since a condition of the status of a holder in due course under Section 3—302(1) (a) is that the holder takes the instrument without notice of any defense against it, this condition presupposes that

at the time of taking such a holder had no knowledge of the unauthorized signature. Consequently, the warranty of subsection (1) (b) is pertinent in the case of a holder in due course only in the relatively few cases where he acquires knowledge of the forgery after the taking but before the presentment. In this situation the holder in due course must continue to act in good faith to be exempted from the basic warranty.

The first exemption from the warranty by such a holder, made by subparagraph (i), is that the warranty does not run to a maker of a note with respect to the maker's own signature. This codifies the rule of *Price v. Neal*, and related cases. Since a maker of a note is presumed to know his own signature, if he fails to detect a forgery of his own signature and pays the note, under the *Price v. Neal* principle he should not be permitted to recover such payment from a holder in due course acting in good faith. Similarly, under subparagraph (ii) a drawer of a draft is presumed to know his own signature and if he fails to detect a forgery of his signature and pays a draft he may not recover that payment from a holder in due course acting in good faith. This rule applies if the drawer pays the instrument as drawer and also if he pays the instrument as drawee in a case where he is both drawer and drawee.

Under the principle of *Price v. Neal* a drawee of a draft is presumed to know the signature of his customer, the drawer. However, under subsection (1) (b) and subparagraph (iii) of this subsection this presumption is not strong enough to deprive such a drawee (either in accepting or paying an instrument) of the warranty of no knowledge of the unauthorized drawer's signature, unless the holder in due course took the instrument and became such a holder after the drawee's acceptance; or obtained the acceptance without knowledge that the drawer's signature was unauthorized. In the former case, the holder taking after and thereby presumably in reliance on the acceptance should be protected as against the drawee who accepted without detecting the unauthorized signature. In the latter case the holder, having no knowledge of the unauthorized signature at the time of the drawee's acceptance, would not be charged with this warranty and would be entitled to enforce such acceptance under Section 3-418, even if thereafter he acquired knowledge of the unauthorized signature prior to enforcement of the acceptance. Such right of the holder to enforce the

acceptance would be valueless if immediately upon enforcing it and obtaining payment the holder became obligated to return the payment by reason of breach of the warranty of no knowledge at the time of payment.

5. Subsection (1) (c) retains the common law rule, followed by several decisions under the original Act, which has permitted a party paying a materially altered instrument in good faith to recover, and a party who accepts such an instrument to avoid such acceptance. As in the case of subsection (1) (b) this warranty is not imposed against a holder in due course acting in good faith in favor of a maker of a note or a drawer of a draft on the ground that such maker or drawer should know the form and amount of the note or draft which he has signed. The exception made by subparagraph (iii) in the case of a holder in due course of a draft accepted after the alteration follows the decisions in *National City Bank of Chicago v. National Bank of Republic of Chicago*, 300 Ill. 103, 132 N.E. 832, 22 A.L.R. 1153 (1921), and *Wells Fargo Bank & Union Trust Company v. Bank of Italy*, 214 Cal. 156, 4 P.2d 781 (1931), and is based on the principle that an acceptance is an undertaking relied upon in good faith by an innocent party. The attempt to avoid this result by certifying checks "payable as originally drawn" leaves the subsequent purchaser in uncertainty as to the amount for which the instrument is certified, and so defeats the entire purpose of certification, which is to obtain the definite obligation of the bank to honor a definite instrument. Subparagraph (iii) accordingly provides that such language is not sufficient to impose on the holder in due course the warranty of no material alteration where the holder took the draft after the acceptance and presumably in reliance on it.

Subparagraph (iv) of subsection (1) (c) exempts a holder in due course from the warranty of no material alteration to the acceptor of a draft with respect to an alteration made after the acceptance. A drawee accepting a draft has an opportunity of ascertaining the form and particularly the amount of the draft accepted. If, thereafter, the draft is materially altered and is thereupon presented for payment to the acceptor, the acceptor has the necessary information in its records to verify the form and particularly the amount of the draft. If in spite of this available information it pays the draft, there is as much reason to leave the re-



sponsibility for such payment upon the acceptor (as against a holder in due course acting in good faith) as there is in the case of a maker or drawer paying a materially altered note or draft.

6. Under Section 3—201 parties taking from or holding under a holder in due course, within the limits of that section, will have the same rights under Section 4—317(1) as a holder in due course. Of course such parties claiming under a holder in due course must act in good faith and be free from fraud, illegality and notice as provided in Section 3—201.

7. The liabilities imposed by subsection (2) in favor of the immediate transferee apply to all persons who transfer an instrument for consideration whether or not the transfer is accompanied by indorsement. Any consideration sufficient to support a simple contract will support those warranties.

8. Subsection (2) changes the original Section 65 to extend the warranties of any indorser beyond the immediate transferee in all cases. Where there is an indorsement the warranty runs with the instrument and the remote holder may sue the indorser-warrantor directly and thus avoid a multiplicity of suits which might be interrupted by the insolvency of an intermediate transferor. The language of subsections (2) (b) and (2) (c) is substituted for "genuine and what it purports to be" in the original Section 65(1). The language of subsection (2) (a) is substituted for that of Section 65(2) in order to cover the case of the agent who transfers for another.

9. Subsection (2) (d) resolves a conflict in the decisions as to whether the transferor warrants that there are no defenses to the instrument good against him. The position taken is that the buyer does not undertake to buy an instrument incapable of enforcement, and that in the absence of contrary understanding the warranty is implied. Even where the buyer takes as a holder in due course who will cut off the defense, he still does not undertake to buy a lawsuit with the necessity of proving his status. Subsection (3) however provides that an indorsement "without recourse" limits the (2) (d) warranty to one that the indorser has no knowledge of such defenses. With

this exception the liabilities of a "without recourse" indorser under this section are the same as those of any other transferor. Under Section 3—414 "without recourse" in an indorsement is effective to disclaim the general contract of the indorser stated in that section.

10. Subsection (2) (e) is substituted for Section 65(4). The transferor does not warrant against difficulties of collection, apart from defenses, or against impairment of the credit of the obligor or even his insolvency in the commercial sense. The buyer is expected to determine such questions for himself before he takes the obligation. If insolvency proceedings as defined in this Act (Section 1—201) have been instituted against the party who is expected to pay and the transferor knows it, the concealment of that fact amounts to a fraud upon the buyer, and the warranty against knowledge of such proceedings is provided accordingly.

11. Subsection (4) is substituted for Section 69 of the original Act. It applies only to a selling agent, as distinguished from an agent for collection. It follows the rule generally accepted that an agent who makes the disclosure warrants his good faith and authority and may not by contract assume a lesser warranty.

#### Cross references:

Sections 3—404, 3—405, 3—406, 3—414 and 4—207.

Point 1: Section 4—207.

Point 2: Section 3—418.

Point 4: Sections 3—201, 3—302 and 3—418.

Point 9: Section 3—414.

Point 10: Section 1—201.

#### Definitional cross references:

"Acceptance". Section 3—410.

"Alteration". Section 3—407.

"Bank". Section 1—201.

"Draft". Section 3—104.

"Genuine". Section 1—201.

"Good faith". Section 1—201.

"Holder in due course". Section 3—302.

"Instrument". Section 3—102.

"Note". Section 3—104.

"Party". Section 1—201.

"Person". Section 1—201.

"Signature". Section 3—401.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* This is a new section intended to state the presentor's warranties to the party who accepts or pays.

See Official Comments 2-5 for a long discussion of this subsection.

Closely related to this subsection is GS 25-4-207 (warranties of customer and collecting bank on transfer or presentment of items; time for claims).

*Subsection (2):* This covers the warran-



ties of one who transfers and receives consideration.

*Subsection (3):* This limits the warranties of one who transfers "without recourse."

**§ 25-3-418. Finality of payment or acceptance.**—Except for recovery of bank payments as provided in the article on bank deposits and collections (article 4) and except for liability for breach of warranty on presentment under the preceding section [§ 25-3-417], payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment. (1899, c. 733, s. 62; Rev., s. 2211; C. S., s. 3043; 1965, c. 700, s. 1.)

**Until Acceptance Drawee Is Not Liable.**—A drawee (unless also the drawer) becomes liable for the payment of a draft

*Subsection (4):* This covers the warranties of a selling agent or broker. Generally, it is not believed that this section makes any great changes in North Carolina law.

only upon his acceptance thereof. *Branch Banking & Trust Co. v. Bank of Washington*, 255 N.C. 205, 120 S.E.2d 830 (1961).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 62, Uniform Negotiable Instruments Law.

**Changes:** Completely restated.

**Purposes of changes:**

The rewording is intended to remove a number of uncertainties arising under the original section.

1. The section follows the rule of *Price v. Neal*, 3 Burr. 1354 (1762), under which a drawee who accepts or pays an instrument on which the signature of the drawer is forged is bound on his acceptance and cannot recover back his payment. Although the original Act is silent as to payment, the common law rule has been applied to it by all but a very few jurisdictions. The traditional justification for the result is that the drawee is in a superior position to detect a forgery because he has the maker's signature and is expected to know and compare it; a less fictional rationalization is that it is highly desirable to end the transaction on an instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date when the forgery is discovered.

The rule as stated in the section is not limited to drawees, but applies equally to the maker of a note or to any other party who pays an instrument.

2. The section follows the decisions under the original Act applying the rule of *Price v. Neal* to the payment of overdrafts, or any other payment made in error as to the state of the drawer's account. The same argument for finality applies, with the additional reason that the drawee is responsible for knowing the state of the account before he accepts or pays.

3. The section follows decisions under the original Act, in making payment or acceptance final only in favor of a holder

in due course, or a transferee who has the rights of a holder in due course under the shelter principle. If no value has been given for the instrument the holder loses nothing by the recovery of the payment or the avoidance of the acceptance, and is not entitled to profit at the expense of the drawee; and if he has given only an executory promise or credit he is not compelled to perform it after the forgery or other reason for recovery is discovered. If he has taken the instrument in bad faith or with notice he has no equities as against the drawee.

4. The section rejects decisions under the original Act permitting recovery on the basis of mere negligence of the holder in taking the instrument. If such negligence amounts to a lack of good faith as defined in this Act (Section 1—201) or to notice under the rules (Section 3—304) relating to notice to a purchaser of an instrument, the holder is not a holder in due course and is not protected; but otherwise the holder's negligence does not affect the finality of the payment or acceptance.

5. This section is to be read together with the preceding section, which states the warranties given by the person obtaining acceptance or payment. It is also limited by the bank collection provision (Section 4—301) permitting a payor bank to recover a payment improperly paid if it returns the item or sends notice of dishonor within the limited time provided in that section. But notice that the latter right is sharply limited in time, and terminates in any case when the bank has made final payment, as defined in Section 4—213.

#### Cross references:

Sections 3—302, 3—303 and 3—417.

Point 2: Section 3—201(1).

Point 4: Sections 1—201, 3—302 and 3—304.

Point 5: Sections 3—417, 4—213 and 4—301.

**Definitional cross references:**

“Acceptance”. Section 3—410.

“Account”. Section 4—104.

“Bank”. Section 1—201.

“Holder in due course”. Section 3—302.

“Instrument”. Section 3—102.

“Presentment”. Section 3—504.

### NORTH CAROLINA COMMENT

Though this section completely restates the rules relating to finality of payment or acceptance, it basically follows the rule of the leading case of *Price v. Neal*, 3 Burr. 1354 (1762).

The section provides that the rules of GS 25-3-417 (warranties on presentment and transfer) and article 4 (especially GS 25-4-207 and 25-4-301) must be read in conjunction with this section. See also GS 25-4-213 (final payment by payor bank, etc.).

It is not believed that this section makes any significant change in North Carolina law. See *Woodward v. Savings & Trust Co.*, 178 N.C. 184, 100 S.E. 304 (1919), held, bank normally cannot recover a payment from a holder because drawer's name is forged; but if depositor knew of forgery, bank can charge back the forged item against him.

### § 25-3-419. Conversion of instrument; innocent representative.—

(1) An instrument is converted when

(a) a drawee to whom it is delivered for acceptance refuses to return it on demand; or

(b) any person to whom it is delivered for payment refuses on demand either to pay or to return it; or

(c) it is paid on a forged indorsement.

(2) In an action against a drawee under subsection (1) the measure of the drawee's liability is the face amount of the instrument. In any other action under subsection (1) the measure of liability is presumed to be the face amount of the instrument.

(3) Subject to the provisions of this chapter concerning restrictive indorsements a representative, including a depository or collecting bank, who has in good faith and in accordance with the reasonable commercial standards applicable to the business of such representative dealt with an instrument or its proceeds on behalf of one who was not the true owner is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands.

(4) An intermediary bank or payor bank which is not a depository bank is not liable in conversion solely by reason of the fact that proceeds of an item indorsed restrictively (§§ 25-3-205 and 25-3-206) are not paid or applied consistently with the restrictive indorsement of an indorser other than its immediate transferor. (1899, c. 733, s. 137; Rev., s. 2287; C. S., s. 3119; 1949, c. 954; 1965, c. 700, s. 1.)

**Inapplicable to Collection of Drafts by Creditor on Debtor.**—The provisions of the NIL as to the liability of a drawee retaining or destroying a bill did not apply to drafts drawn by a creditor against his

debtor and sent to a bank for collection. *Branch Banking & Trust Co. v. Bank of Washington*, 255 N.C. 205, 120 S.E.2d 830 (1961).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 137, Uniform Negotiable Instruments Law.

**Changes:** Rule changed; new provisions.

**Purpose of changes and new matter:** To remove difficulties arising under the original section, and to cover additional situations:

1. The provision of the original Section 137 that refusal to return a bill presented

for acceptance is deemed to be acceptance has led to difficulties. If the bill is accepted it is not dishonored, and the holder is left without recourse against the drawer and indorsers when he has most need for immediate recourse. The drawee does not in fact accept and does everything he can to display an intention not to accept; and the “acceptance” is useless to the holder for any purpose other than an action against

the drawee, since he has nothing that he can negotiate. The original rule has therefore been changed (see Section 3—410).

2. A negotiable instrument is the property of the holder. It is a mercantile specialty which embodies rights against other parties, and a thing of value. This section adopts the generally recognized rule that a refusal to return it on demand is a conversion. The provision is not limited to drafts presented for acceptance, but extends to any instrument presented for payment, including a note presented to the maker. The action is not on the instrument, but in tort for its conversion.

The detention of an instrument voluntarily delivered is not wrongful unless and until there is demand for its return. Demand for a return at a particular time may, however, be made at the time of delivery; or it may be implied under the circumstances or understood as a matter of custom. If the holder is to call for the instrument and fails to do so, he is to be regarded as extending the time. "Refuses" is meant to cover any intentional failure to return the instrument, including its intentional destruction. It does not cover a negligent loss or destruction, or any other unintentional failure to return. In such a case the party may be liable in tort for any damage sustained as a result of his negligence, but he is not liable as a converter under this section.

3. Subsection (1) (c) is new. It adopts the prevailing view of decisions holding that payment on a forged indorsement is not an acceptance, but that even though made in good faith it is an exercise of dominion and control over the instrument inconsistent with the rights of the owner, and results in liability for conversion.

4. Subsection (2) is new. It adopts the rule generally applied to the conversion of negotiable instruments, that the obligation of any party on the instrument is presumed, in the sense that the term is defined in this Act (Section 1—201), to be worth its face value. Evidence is admissible to show that for any reason such as insolvency or the existence of a defense the

obligation is in fact worth less, or even that it is without value. In the case of the drawee, however, the presumption is replaced by a rule of absolute liability.

5. Subsection (3), which is new, is intended to adopt the rule of decisions which has held that a representative, such as a broker or depository bank, who deals with a negotiable instrument for his principal in good faith is not liable to the true owner for conversion of the instrument or otherwise, except that he may be compelled to turn over to the true owner the instrument itself or any proceeds of the instrument remaining in his hands. The provisions of subsection (3) are, however, subject to the provisions of this Act concerning restrictive indorsements (Sections 3—205, 3—206 and related sections).

6. The provisions of this section are not intended to eliminate any liability on warranties of presentment and transfer (Section 3—417). Thus a collecting bank might be liable to a drawee bank which had been subject to liability under this section, even though the collecting bank might not be liable directly to the owner of the instrument.

#### Cross references:

Sections 3—409, 3—410, 3—411 and 3—603.

Point 4: Section 1—201.

Point 5: Sections 1—201, 3—205 and 3—206.

Point 6: Section 3—417.

#### Definitional cross references:

"Acceptance". Section 3—410.

"Action". Section 1—201.

"Bank". Section 1—201.

"Collecting bank". Sections 3—102 and 4—105.

"Depository bank". Sections 3—102 and 4—105.

"Good faith". Section 1—201.

"Instrument". Section 3—102.

"Intermediary bank". Sections 3—102 and 4—105.

"On demand". Section 3—108.

"Person". Section 1—201.

"Presumed". Section 1—201.

"Representative". Section 1—201.

### NORTH CAROLINA COMMENT

As noted under GS 25-3-410, the NIL 137 (GS 25-144) rule of constructive acceptance by refusal to return or delay in returning a presented instrument has been changed. This section, however, would make the party who refuses to return an instrument liable as a converter

for the face amount of the instrument. Thus, the liability of a wrongdoing drawee will be the same as if there had been a constructive acceptance.

This section helps make the law in North Carolina more certain.



## PART 5.

## PRESENTMENT, NOTICE OF DISHONOR AND PROTEST.

**§ 25-3-501. When presentment, notice of dishonor, and protest necessary or permissible.**—(1) Unless excused (§ 25-3-511) presentment is necessary to charge secondary parties as follows:

(a) presentment for acceptance is necessary to charge the drawer and indorsers of a draft where the draft so provides, or is payable elsewhere than at the residence or place of business of the drawee, or its date of payment depends upon such presentment. The holder may at his option present for acceptance any other draft payable at a stated date;

(b) presentment for payment is necessary to charge any indorser;

(c) in the case of any drawer, the acceptor of a draft payable at a bank or the maker of a note payable at a bank, presentment for payment is necessary, but failure to make presentment discharges such drawer, acceptor or maker only as stated in § 25-3-502 (1) (b).

(2) Unless excused (§ 25-3-511)

(a) notice of any dishonor is necessary to charge any indorser;

(b) in the case of any drawer, the acceptor of a draft payable at a bank or the maker of a note payable at a bank, notice of any dishonor is necessary, but failure to give such notice discharges such drawer, acceptor or maker only as stated in § 25-3-502 (1) (b).

(3) Unless excused (§ 25-3-511) protest of any dishonor is necessary to charge the drawer and indorsers of any draft which on its face appears to be drawn or payable outside of the states and territories of the United States and the District of Columbia. The holder may at his option make protest of any dishonor of any other instrument and in the case of a foreign draft may on insolvency of the acceptor before maturity make protest for better security.

(4) Notwithstanding any provision of this section, neither presentment nor notice of dishonor nor protest is necessary to charge an indorser who has indorsed an instrument after maturity. (1899, c. 733, ss. 70, 89, 118, 129, 143, 144, 150 to 153, 158, 186; Rev., ss. 2219, 2239, 2268, 2279, 2293, 2294, 2300 to 2303, 2308, 2336; C. S., ss. 3051, 3071, 3100, 3111, 3125, 3126, 3132 to 3135, 3140, 3168; 1965, c. 700, s. 1.)

**Presentment Is Necessary to Hold Drawer.**—When a draft on a third person is given in settlement of an antecedent debt, it is the duty of the holder to present it, and a failure to do so will discharge the debt. *Mauney & Son v. Coit*, 80 N.C. 300 (1879).

**And Drawer and Indorsers Must Be Given Notice of Dishonor.**—The draft having been accepted, the drawee becomes primarily liable, and in the event of dishonor, notice must be given to all those who are secondarily liable as drawer and indorsers. *Denny v. Palmer*, 27 N.C. 610 (1845); *Brown v. Teague*, 52 N.C. 573 (1860); *National Bank v. Bradley*, 117 N.C. 526, 23 S.E. 455 (1895).

Following the NIL, it was held in *Perry Co. v. Taylor Bros.*, 148 N.C. 362, 62 S.E. 423 (1908), that failure to give notice of dishonor discharged the indorser from further liability. *Barber v. Absher*, 175 N.C. 602, 96 S.E. 43 (1918).

**But Failure to Present Is Matter of Defense.**—If a note be payable at a partic-

ular time and place, a demand at the time and place need not be averred or proven in an action by the holder against the maker. A failure to make such demand can only be used in defense if the money was ready at the time and place. *Nichols v. Pool*, 47 N.C. 23 (1854).

**Notice of dishonor may be waived by an indorser** of a negotiable paper before or after maturity thereof by express words or by necessary implication, and when so waived, notice of dishonor need not be given. *National Bank v. Johnson*, 159 N.C. 526, 86 S.E. 360 (1912). See § 25-3-511.

**But Consenting to Extension Is Not Such Waiver.**—It cannot be determined as a matter of law that an indorser is not entitled to notice of dishonor, as provided in the NIL, by reason of his consent to an extension of time of payment granted the principal. *Davis v. Royall*, 204 N.C. 147, 167 S.E. 559 (1933).

**Burden Is on Holder to Show Notice of Dishonor Was Not Required.**—The burden is on the holder of a note, seeking to

hold an indorser, to whom notice of dishonor has not been given, liable thereon upon the contention that notice was not required, to prove that the note was given for his accommodation. Parol evidence is not admissible to show primary liability to sustain the contention that notice of dishonor is dispensed with. *Busbee v. Creech*, 192 N.C. 499, 135 S.E. 326 (1926).

**Recovery by Forwarding Bank Limited to Loss Actually Caused.**—When a bank forwards a check to another bank to be collected, and the drawee bank is negligent in notifying the forwarding bank of

nonpayment, the right of the forwarding bank to recover will be determined by whether or not it would have prevented loss by notice, and it can recover such loss only as was occasioned by the delay. *American Nat'l Bank v. Savannah Trust Co.*, 177 N.C. 254, 98 S.E. 595 (1919).

**Former Rule on Protest.**—Protest was not necessary to fix the drawee and indorsers of inland bills of exchange with liability, although it was necessary in the case of foreign bills. *Shaw Bros. v. McNeill*, 95 N.C. 535 (1886).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 70, 89, 118, 129, 143, 144, 150, 151, 152, 157, 158 and 186, Uniform Negotiable Instruments Law.

**Changes:** Combined and simplified.

**Purposes of changes:**

1. Part 5 simplifies the requirements of the original Act as to presentment for acceptance or payment, notice of dishonor and protest. This section assembles in one place all provisions as to when any such proceeding is necessary. It eliminates some of the requirements and simplifies others. The effect of unexcused delay in any such proceeding as a discharge is covered by the next section, and the sections following prescribe the details of the proceedings.

2. The words "Necessary to charge" are retained from the original Act. They mean that the necessary proceeding is a condition precedent to any right of action against the drawer or indorser. He is not liable and cannot be sued without the proceedings however long delayed. Under some circumstances delay is excused. If it is not excused it may operate as a discharge under the next section. Under some circumstances the proceeding may be entirely excused and the drawer or indorser is then liable as if the proceeding had been duly taken. Section 3—511 states the circumstances under which delay may be excused or the proceeding entirely excused.

3. Subsection (1) (a) retains the substance of the original Sections 143, 144 and 150. The last sentence of the subsection states the rule of the decisions both at common law and under the original Act, that the holder may at his option present any time draft for acceptance, and is not required to wait until the due date to know whether the drawee will accept it; but that if he does make presentment and acceptance is refused he must give notice of dishonor. There is no similar right to present for acceptance a draft payable

on demand, since a demand draft entitles the holder to immediate payment but not to acceptance.

4. Subsections (1) (b) and (1) (c) on presentment for payment follow Section 70 of the original Act with one important change. Under the original Act and under this section ((1) (b)) presentment for payment is necessary (unless excused) to charge any drawer. Under the original Act drawers of drafts other than checks were wholly discharged by a failure to make due presentment but drawers of checks (Section 70 in conjunction with Section 186) were discharged only "to the extent of the loss caused by the delay"—that is to say, when insolvency of the drawee bank occurred after the time when presentment was due. The check rule of the original Act (somewhat modified—see Section 3—502(1) (b) and Comment thereto) is by subsection (1) (c) extended to all drawers, and also to the acceptors and makers of domiciled—"payable at a bank"—drafts and notes. Thus drawers of drafts other than checks are not, as they were under Section 70, wholly discharged by failure to make due presentment but, like drawers of checks, are discharged only as they may have suffered loss as provided in Section 3—502(1) (b). As to domiciled paper original Section 70 provided that ability and willingness to pay at the place named at maturity were "equivalent to a tender of payment"—that is to say would stop the running of interest, but had no other effect. Accordingly cases have held that makers and acceptors of domiciled paper were not discharged to any extent by the holder's failure to make presentment even when the obligor had funds available in the paying bank on the date for presentment and the bank subsequently failed. Subsection (1) (c) applies the check rule to such makers and acceptors; the "tender" language of Section 70 is eliminated; and the result in the cases referred

to in the preceding sentence is reversed. Under this section as under the original Act presentment for payment is not necessary to charge primary parties (makers and acceptors of undomiciled paper).

5. Under subsection (2) the rules as to necessity of notice of dishonor run parallel with the rules as to necessity of presentment stated in subsection (1).

6. Under the original Sections 129 and 152 protest is required in the case of every "foreign draft", defined as a draft which on its face is not both drawn and payable "within this state." The result has been that upon dishonor in New York a check which appears on its face to be drawn in Jersey City must be protested in order to sue the drawer or any indorser. This has led to great inconvenience and expense of protest fees. The only function of protest is that of proof of dishonor, and it adds nothing to notice of dishonor as such.

Subsection (3) eliminates the requirement of protest except upon dishonor of a draft which on its face appears to be either drawn or payable outside of the United States. The requirement is left as to such international drafts because it is generally required by foreign law, which this Article cannot affect. The formalities of protest are covered by Section 3-509 on protest, and substitutes for protest as proof of dishonor are provided for in Section 3-510 on evidence of dishonor and of notice.

This provision retains from the original Section 118 the rule permitting the holder at his option to make protest of any dishonor of any other instrument. Even where not required protest may have definite convenience where process does not run to another state and the taking of depositions is a slow and expensive matter. Even where the instrument is drawn and payable entirely within a state there may be convenience in saving the trip of a witness from Buffalo to New York to testify to dishonor, where the substitute evidence of dishonor and notice of dishonor cannot be relied on. Either required or optional protest is presumptive evidence of dishonor. (Section 3-510.)

7. The permissible "protest for better security" of original Section 158 is retained in the case of a foreign draft, as the practice is common in certain foreign countries.

8. Under the final sentence of Section 7 of the original Act an instrument indorsed when overdue became payable on demand as to the indorser. That language has been deleted from this Article—see Section 3-108 and Comment. It meant, among other things and in view of the provisions of the original Act as to demand paper, that such an indorser was discharged unless the instrument was presented for payment within a reasonable time after his indorsement. Presentment of overdue paper for the purpose of charging an indorser is unusual and not an expected commercial practice; the rule has been little more than a trap for those not familiar with the Act. Subsection (4), reversing the original Act, provides that as to indorsers after maturity neither presentment nor notice of dishonor nor protest is necessary; like primary parties therefore they will remain liable on the instrument for the period of the applicable statute of limitations.

#### Cross references:

Point 1: Sections 3-502 through 3-508.

Point 2: Sections 3-413, 3-414 and 3-511.

Point 3: Sections 3-413, 3-414 and 3-511.

Point 4: Section 3-502.

Point 6: Sections 3-413, 3-414, 3-509, 3-510 and 3-511.

Point 8: Section 3-108.

#### Definitional cross references:

"Acceptance". Section 3-410.

"Bank". Section 1-201.

"Certificate of deposit". Section 3-104.

"Dishonor". Section 3-507.

"Draft". Section 3-104.

"Holder". Section 1-201.

"Instrument". Section 3-102.

"Note". Section 3-104.

"Notice of dishonor". Section 3-508.

"Party". Section 1-201.

"Presentment". Section 3-504.

"Protest". Section 3-509.

"Secondary party". Section 3-102.

"Signature". Section 3-401.

### NORTH CAROLINA COMMENT

*Subsection (1):* Unless presentment is "excused" under GS 25-3-511, a proper presentment is necessary to charge secondary parties. See Official Comments 2-4 for long explanation.

*Subsection (2):* Unless excused by GS 25-3-511, notice of dishonor is necessary

to charge: (a) Any indorser, (b) any drawer, (c) the acceptor of a draft payable at a bank, or (d) the maker of a note payable at a bank.

(*Note:* Normally, acceptors of drafts and makers of notes are considered as primary parties; however, when their in-



struments are payable at banks, they are entitled to notice of any dishonor. See GS 25-3-121.)

*Subsection (3):* This subsection on protest is perhaps the biggest change from the NIL. Under GS 25-159 (NIL, 152) any foreign bill had to be protested; and "foreign" under GS 25-136 (NIL, 129) meant any instrument not drawn and payable within a single state. The UCC now requires protest only when the instrument on its face is drawn or payable outside the United States.

**§ 25-3-502. Unexcused delay; discharge.**—(1) Where without excuse any necessary presentment or notice of dishonor is delayed beyond the time when it is due

(a) any indorser is discharged; and

(b) any drawer or the acceptor of a draft payable at a bank or the maker of a note payable at a bank who because the drawee or payor bank becomes insolvent during the delay is deprived of funds maintained with the drawee or payor bank to cover the instrument may discharge his liability by written assignment to the holder of his rights against the drawee or payor bank in respect of such funds, but such drawer, acceptor or maker is not otherwise discharged.

(2) Where without excuse a necessary protest is delayed beyond the time when it is due any drawer or indorser is discharged. (1899, c. 733, ss. 7, 70, 89, 144, 150, 152, 186; Rev., ss. 2157, 2219, 2239, 2294, 2300, 2302, 2336; C. S., ss. 2988, 3051, 3071, 3126, 3132, 3134, 3168; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 7, 70, 89, 144, 150, 152 and 186, Uniform Negotiable Instruments Law.

**Changes:** Combined and simplified.

**Purposes of changes:**

This section is the complement of the preceding section. It covers in one section widely scattered provisions of the original Act:

1. The circumstances under which presentment or notice of dishonor or protest or delay therein are excused are stated in Section 3—511. When not excused delay operates as a discharge as provided in this section.

2. Subsection (1) (b) applies to any drawer, as well as to the makers and acceptors of drafts and notes payable at a bank, the rule of the original Section 186 providing for discharge only where the drawer of a check has sustained loss through the delay. This section expressly limits the rule to loss sustained through insolvency of the drawee or payor which was the only type of loss to which the Section 186 rule has ever been applied in the cases arising under it.

The purpose of the rule is to avoid hardship upon the holder through complete discharge, and unjust enrichment of the drawer or other party who normally has received goods or other consideration for

The holder has an option to make protest of any dishonor, and in the case of a foreign draft may on insolvency of the acceptor make a protest for better security before maturity. See GS 25-165 (NIL, 158).

*Subsection (4):* This reverses the rule of GS 25-159 (NIL, 152), and neither presentment, notice of dishonor nor protest is necessary to charge an indorser who indorses after maturity.

the issue of the instrument. He is "deprived of funds" in any case where bank failure or other insolvency of the drawee or payor has prevented him from receiving the benefit of funds which would have paid the instrument if it had been duly presented.

The original language discharging the drawer "to the extent of the loss caused by the delay" has not worked out satisfactorily in the decided cases, since the amount of the loss caused by the failure of a bank is almost never ascertainable at the time of suit and may not be ascertained until some years later. The decisions have turned upon burden of proof, and the drawer has seldom succeeded in proving his discharge. Subsection (1) (b) therefore substitutes a right to discharge liability by written assignment to the holder of rights against the drawee or payor as to the funds which cover the particular instrument. The assignment is intended to give the holder an effective right to claim against the drawee or payor.

3. Subsection (2) retains the rule of the original Section 152, that any unexcused delay of a required protest is a complete discharge of all drawers and indorsers.

**Cross references:**

Point 1: Section 3—511(1).

Point 2: Section 3—501.

Point 3: Section 3—509.

**Definitional cross references:**

"Bank". Section 1—201.

"Draft". Section 3—104.

"Holder". Section 1—201.

"Insolvent". Section 1—201.

"Instrument". Section 3—102.

"Note". Section 3—104.

"Notice of dishonor". Section 3—508.

"Payor bank". Section 4—105.

"Presentment". Section 3—504.

"Protest". Section 3—509.

"Rights". Section 1—201.

"Signature". Section 3—401.

"Written". Section 1—201.

**NORTH CAROLINA COMMENT**

GS 25-3-502 complements GS 25-3-501.

*Subsection (1):* This states the effect of an unexcused failure to present and to give notice of dishonor. The extent of discharge differs with the class of secondary party: (1) Indorsers are fully discharged; (2) the more limited discharge of other parties is covered in subsection (1) (b), which adopts a sort of pro tanto discharge concept.

*Subsection (2):* Failure to make necessary protest will discharge a drawer or indorser in full.

*North Carolina cases on presentment:* Philadelphia Life Ins. Co. v. Hayworth,

296 Fed. 339 (4th Cir. 1924). Held: Demand instruments, including postdated checks, must be presented for payment within reasonable time after issue; but the only effect of a late presentment against a drawer is to discharge him to the extent that the delay caused him loss.

Rouse v. Wooten, 140 N.C. 557, 53 S.E. 430 (1906), and Dry v. Reynolds, 205 N.C. 571, 172 S.E. 351 (1934), seem to say: (1) Presentment is not necessary to charge a surety; (2) presentment is necessary to charge a guarantor. See also GS 25-3-415 (contract of accommodation party) and GS 25-3-416 (contract of guarantor).

**§ 25-3-503. Time of presentment.**—(1) Unless a different time is expressed in the instrument the time for any presentment is determined as follows:

(a) where an instrument is payable at or a fixed period after a stated date any presentment for acceptance must be made on or before the date it is payable;

(b) where an instrument is payable after sight it must either be presented for acceptance or negotiated within a reasonable time after date or issue whichever is later;

(c) where an instrument shows the date on which it is payable presentment for payment is due on that date;

(d) where an instrument is accelerated presentment for payment is due within a reasonable time after the acceleration;

(e) with respect to the liability of any secondary party presentment for acceptance or payment of any other instrument is due within a reasonable time after such party becomes liable thereon.

(2) A reasonable time for presentment is determined by the nature of the instrument, any usage of banking or trade and the facts of the particular case. In the case of an uncertified check which is drawn and payable within the United States and which is not a draft drawn by a bank the following are presumed to be reasonable periods within which to present for payment or to initiate bank collection:

(a) with respect to the liability of the drawer, thirty days after date or issue whichever is later; and

(b) with respect to the liability of an indorser, seven days after his indorsement.

(3) Where any presentment is due on a day which is not a full business day for either the person making presentment or the party to pay or accept, presentment is due on the next following day which is a full business day for both parties.

(4) Presentment to be sufficient must be made at a reasonable hour, and if at a bank during its banking day. (1899, c. 733, ss. 71, 72, 75, 85, 86, 144 to 146, 186, 193; Rev., ss. 2220, 2221, 2224, 2234, 2236, 2294 to 2296, 2336, 2343; 1907, c. 897; 1909, c. 800, s. 1; C. S., ss. 2978, 3052, 3053, 3056, 3066, 3068, 3126 to 3128, 3168; 1965, c. 700, s. 1.)

**Presentment Must Be Made in Reasonable Time to Hold Drawer.**—A drawer of a bill, having funds in the hands of the drawee has a right that the bill be pre-

sented for payment, and he cannot be charged unless the bill was presented in a reasonable time, although he knew at the time of drawing the bill that the drawee

was insolvent. *Long v. Stephenson*, 72 N.C. 569 (1875); *Cedar Falls Co. v. Wallace*, 83 N.C. 225 (1880).

A "check" is a bill of exchange drawn on a bank, payable on demand, and instruments payable on demand may be presented within a reasonable time after their issue. *Philadelphia Life Ins. Co. v. Hayworth*, 296 Fed. 339 (4th Cir. 1924).

Instruments payable on demand may be presented within a reasonable time after their issue. In this respect there is no difference between a postdated check and any other. In either case it should be presented within a reasonable time after its issue, but the only effect of a failure to present it within such time is to discharge the drawer from liability to the extent of the loss caused by the delay. *Philadelphia Life Ins. Co. v. Hayworth*, 296 Fed. 339 (4th Cir. 1924).

A postdated check, like any other check need not be presented on the day of its date, but may be presented within a reasonable time thereafter, and the fact that the drawee had money on deposit to meet it on that date, but did not have it when the check was presented, is not equivalent to a "tender of payment." *Philadelphia Life Ins. Co. v. Hayworth*, 296 Fed. 339 (4th Cir. 1924).

The holder of a check upon a bank located in the town of his residence may present it for payment on the day after the same is drawn, and his omission to present it sooner is no defense to the drawee bank, unless he had information of its precarious condition. *First Nat'l Bank v. Alexander*, 84 N.C. 30 (1881).

Under the law merchant where a negotiable paper was assigned, the assignee was bound to apply for payment within a reasonable time. *Plummer v. Christmas*, 1 N.C. 145 (1799).

**"Reasonable Time" Is Dependent upon Circumstances.**—What constitutes reasonable time will vary under the facts and circumstances of different cases. *Manufacturing Co. v. Summers*, 143 N.C. 102, 55 S.E. 522 (1906).

Though it be inconvenient to have several rules, applicable to different classes of persons, it is more so to have one applied to all, which is wholly unsuited to the habits, transactions, and experience of the greater number. It is impossible to lay down a rule in the abstract which is equally just in its bearing on all persons to be affected by it; it must depend upon the circumstances of the case, and must be determined by the jury, under the directions of the court. *Raines v. Grantham*, 205 N.C. 340, 171 S.E. 360 (1933), citing *Brittain v. Johnson*, 12 N.C. 293 (1827).

A check is only conditional payment, but the payee must exercise due diligence in presenting it for payment, and where his failure to exercise such diligence causes loss he must suffer it, due diligence being determined in accordance with the facts and circumstances of each particular case. *Henderson Chevrolet Co. v. Ingle*, 202 N.C. 158, 162 S.E. 219 (1932).

**Facts to Be Considered.**—In determining what is a reasonable time for the presentation of a check for payment regard must be had to the nature of the instrument, the customs and usages of trade in regard to such instrument, and the facts of the particular case. *Raines v. Grantham*, 205 N.C. 340, 171 S.E. 360 (1933).

**Time Held Unreasonable.**—Four months, when the parties all resided in the same village, is an unreasonable time in making a demand of the maker of a note and giving notice of nonpayment to the indorser. *Yancey v. Littlejohn*, 9 N.C. 525 (1823).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 71, 72, 75, 85, 86, 144, 145, 146, 186 and 193, Uniform Negotiable Instruments Law.

**Changes:** Combined and simplified; new provisions.

**Purposes of changes and new matter:**

1. This section states in one place all of the rules applicable to the time of presentment. Excused delay is covered by Section 3—511 on waiver and excuse, and the effect of unexcused delay by Section 3—502 on discharge.

The original Section 86, as to the determination of the time of payment by calculation from the day the time is to run, is omitted as superfluous. It states a rule

universally applied to all time calculations in the law of contracts, and has no special application to negotiable instruments. No change in the law is intended.

2. Subsection (1) contains new provisions stating the commercial understanding as to the presentment of instruments payable after sight, and of accelerated paper.

3. Subsection (2) retains the substance of the original Section 193 as to the determination of a reasonable time. It provides specific time limits which are presumed, as that term is defined in this Act (Section 1—201), to be reasonable for uncertified checks drawn and payable within the continental limits of the United States. The court-made time limit of one day after



the receipt of the instrument found in decisions under the original Act has proved to be too short a time for some holders, such as the department store or other large business clearing many checks through its books shortly after the first of the month, as well as the farmer or other individual at a distance from a bank.

The time limit provided differs as to drawer and indorser. The drawer, who has himself issued the check and normally expects to have it paid and charged to his account is reasonably required to stand behind it for a longer period, especially in view of the protection now provided by Federal Deposit Insurance. The thirty days specified coincides with the time after which a purchaser has notice that a check has become stale (Section 3—304(3) (c)). The indorser, who has normally merely received the check and passed it on, and does not expect to have to pay it, is entitled to know more promptly whether it is to be dishonored, in order that he may have recourse against the person with whom he has dealt.

4. Subsection (3) replaces the original Sections 85 and 146. It is intended to make allowance for the increasing practice of closing banks or businesses on Saturday or other days of the week. It is not intended to mean that any drawee or obligor

can avoid dishonor of instruments by extended closing.

5. Subsection (4) eliminates the provision of the original Section 75 permitting presentment "at any hour before the bank is closed" if the drawer has no funds in the bank. The change is made to avoid inconvenience to the bank.

"Banking day" is defined in Section 4—104.

#### Cross references:

Point 1: Sections 3—501, 3—502, 3—505, 3—506 and 3—511.

Point 3: Sections 1—201 and 3—304(3) (c).

Point 5: Section 4—104

#### Definitional cross references:

"Acceptance". Section 3—410.

"Bank". Section 1—201.

"Banking day". Section 4—104.

"Check". Section 3—104.

"Draft". Section 3—104.

"Instrument". Section 3—102.

"Issue". Section 3—102.

"Party". Section 1—201.

"Person". Section 1—201.

"Presentment". Section 3—504.

"Presumed". Section 1—201.

"Reasonable time". Section 1—204.

"Secondary party". Section 3—102.

"Usage of trade". Section 1—205.

### NORTH CAROLINA COMMENT

Generally, the section covers the time for presentment for acceptance or payment.

Subsection (1) states the details of time for various situations.

Subsection (2) defines "reasonable time." The new provisions of (2) (a) and (2) (b) state definite number of days for timely presentment of uncertified checks drawn and payable in the United States as follows: (a) Timely presentment of a check as against the drawer is 30 days; (b) timely presentment of a check as against an indorser is 7 days. Thus, when this section is read in conjunction with GS 25-3-502 (1) (a), it is seen that an indorser of a check is fully discharged unless presentment is made within 7 days of his in-

dorsement (unless delay is excused under GS 25-3-511). The theory is that most holders can get to bank at least once a week; and if they fail to do so, they should not be able to continue the secondary liability of an indorser.

Subsection (3) replaces GS 25-91 and 25-153 (NIL, 85 and 146), and it recognizes that banks and other businesses close on Saturdays and other days.

Subsection (4) eliminates the provision of GS 25-81 (NIL, 75) permitting presentment at a bank "at any time before the bank is closed" in cases where the drawer has no funds in the bank. The theory is that business with a bank should be conducted during banking hours.

**§ 25-3-504. How presentment made.**—(1) Presentment is a demand for acceptance or payment made upon the maker, acceptor, drawee or other payor by or on behalf of the holder.

(2) Presentment may be made

(a) by mail, in which event the time of presentment is determined by the time of receipt of the mail; or

(b) through a clearing house; or

(c) at the place of acceptance or payment specified in the instrument or if there be none at the place of business or residence of the party to accept or pay. If

neither the party to accept or pay nor anyone authorized to act for him is present or accessible at such place presentment is excused.

(3) It may be made

(a) to any one of two or more makers, acceptors, drawees or other payors; or  
(b) to any person who has authority to make or refuse the acceptance or payment.

(4) A draft accepted or a note made payable at a bank in the United States must be presented at such bank.

(5) In the cases described in § 25-4-210 presentment may be made in the manner and with the result stated in that section. (1899, c. 733, ss. 72, 73, 77, 78, 145; Rev., ss. 2221, 2222, 2226, 2227, 2295; C. S., ss. 3053, 3054, 3058, 3059, 3127; 1963, c. 242; 1965, c. 700, s. 1.)

#### **Presentment Must Be at Place Specified.**

—Whenever a bill of exchange or note is made payable at a particular place, a demand at that place is sufficient, and a personal one is not necessary whether the maker lives at the same place or a different one. *Sullivan v. Mitchell*, 4 N.C. 93 (1814). But the maker is not bound to pay it until it is presented at the place where it is expressed to be payable. *Bank of the State of N.C. v. President & Directors of Bank*, 35 N.C. 75 (1851).

**Or at Party's Residence or Place of Business.**—A draft payable at no definite place in a city or town, must be presented at the maker's residence or place of business, if he has such, at its maturity, and if he has none, then the presence of the instrument in the city is a sufficient presentation. *Peoples Nat'l Bank v. Lutterloh*, 95 N.C. 495 (1886).

**And to Authorized Agent.**—The presentment of a bill of exchange or draft must be made to the drawee or acceptor, or to an authorized agent. A personal demand is not always necessary, and it is sufficient to make the demand at the residence or usual places of business of the drawee, where the presentment is for payment. It is the duty of the bank collector to be careful, not only to present the draft at the usual place of business, but, if the plaintiff was not in, to assure himself that the person to whom he presented the draft for acceptance was the authorized agent of the plaintiff. *Burrus v. Life Ins. Co.*, 124 N.C. 9, 32 S.E. 323 (1899).

**Presentment of a draft for payment at the place of its date is sufficient**, no other place of presentment appearing. *Wittkowski v. Smith*, 84 N.C. 671 (1881).

### **OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 72, 73, 77, 78 and 145, Uniform Negotiable Instruments Law

**Changes:** Combined and simplified.

#### **Purposes of changes:**

1. This section is intended to simplify the rules as to how presentment is made and to make it clear that any demand upon the party to pay is a presentment no matter where or how. Former technical requirements of exhibition of the instrument and the like are not required unless insisted upon by the party to pay (Section 3—505).

2. Paragraph (a) of subsection (2) authorizes presentment by mail directly to the obligor. The presentment is sufficient and the instrument is dishonored by non-acceptance or non-payment even though the party making presentment may be liable for improper collection methods. "Through a clearing house" means that presentment is not made when the demand reaches the clearing house, but when it reaches the obligor. Section 4—210 should also be consulted for the methods of presenting which may properly be em-

ployed by a collecting bank. Subsection (5) of this section makes it clear that presentment made under Section 4—210 is proper presentment.

3. Paragraph (a) of subsection (3) eliminates the requirement of the original Sections 78 and 145(1) that presentment be made to each of two or more makers, acceptors or drawees unless they are partners or one has authority to act for the others. The holder is entitled to expect that any one of the named parties will pay or accept, and should not be required to go to the trouble and expense of making separate presentment to a number of them.

4. Section 3—412 provides that an acceptance made payable at a bank in the United States does not vary the draft. Subsection (4) of this section makes it clear that a draft so accepted must be presented at the bank so designated. The same rule is applied to notes made payable at a bank. The rule of the subsection is in conformity with the provisions of Section 3—501 on presentment and Section 3—502 on the effect of failure to make presentment with reference to domiciled paper.

**Cross references:**

Point 1: Sections 3—501, 3—502, 3—505 and 3—511.

Point 2: Section 4—210.

Point 5: Sections 3—412, 3—501 and 3—502.

**Definitional cross references:**

“Acceptance”. Section 3—410.

“Bank”. Section 1—201.

“Clearing house”. Section 4—104.

“Draft”. Section 3—104.

“Holder”. Section 1—201.

“Instrument”. Section 3—102.

“Note”. Section 3—104.

“Party”. Section 1—201.

“Person”. Section 1—201.

**NORTH CAROLINA COMMENT**

This section simplifies the rules of how presentment is to be made.

By 1963 amendment to GS 25-79, North Carolina adopted the “clearinghouse” provisions of subsection (2) (b).

This section must be read in conjunction with GS 25-4-210 (presentment by notice of item not payable by, through or at a bank; liability of secondary parties).

§ 25-3-505. Rights of party to whom presentment is made.—(1) The party to whom presentment is made may without dishonor require

(a) exhibition of the instrument; and

(b) reasonable identification of the person making presentment and evidence of his authority to make it if made for another; and

(c) that the instrument be produced for acceptance or payment at a place specified in it, or if there be none at any place reasonable in the circumstances; and

(d) a signed receipt on the instrument for any partial or full payment and its surrender upon full payment.

(2) Failure to comply with any such requirement invalidates the presentment but the person presenting has a reasonable time in which to comply and the time for acceptance or payment runs from the time of compliance. (1899, c. 733, s. 74; Rev., s. 2223; C. S., s. 3055; 1965, c. 700, s. 1.)

**Lost or Destroyed Note.**—The provisions of the NIL that upon payment of a note it must be delivered up to the party paying it, did not apply where the note had been lost or destroyed, and, under the facts,

there was no error in not requiring a bond for the protection of the maker where there was no request made therefor. *Wooten v. Bell*, 196 N.C. 654, 146 S.E. 705 (1929).

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 74, Uniform Negotiable Instruments Law.

**Changes:** Expanded and modified.

**Purposes of changes:** To supplement the provisions as to how presentment is made, by permitting the party to whom it is made to insist on additional requirements:

1. In the first instance a mere demand for acceptance or payment is sufficient presentment, and if the payment is unqualifiedly refused nothing more is required. The party to whom presentment is made may, however, require exhibition of the instrument, its production at the proper place, identification of the party making presentment, and a signed receipt on the instrument, or its surrender on full payment. Failure to comply with any such requirement invalidates the presentment and means that the instrument is not dishonored. The time for presentment is, however, extended to give the person present-

ing a reasonable opportunity to comply with the requirements.

2. “Reasonable identification” means identification reasonable under all the circumstances. If the party on whom demand is made knows the person making presentment, no requirement of identification is reasonable, while if the circumstances are suspicious a great deal may be required. The requirement applies whether the instrument presented is payable to order or to bearer.

**Cross references:**

Point 1: Sections 3—504 and 3—506.

**Definitional cross references:**

“Acceptance”. Section 3—410.

“Dishonor”. Section 3—507.

“Instrument”. Section 3—102.

“Party”. Section 1—201.

“Person”. Section 1—201.

“Presentment”. Section 3—504.

“Reasonable time” Section 1—204.

“Signed”. Section 1—201.



## NORTH CAROLINA COMMENT

This section expands and modifies the limited rules of the NIL, on the rights of a party to whom presentment is made.

The section must be read in conjunction with GS 25-3-804 (lost, destroyed or stolen instruments).

**§ 25-3-506. Time allowed for acceptance or payment.**—(1) Acceptance may be deferred without dishonor until the close of the next business day following presentment. The holder may also in a good faith effort to obtain acceptance and without either dishonor of the instrument or discharge of secondary parties allow postponement of acceptance for an additional business day.

(2) Except as a longer time is allowed in the case of documentary drafts drawn under a letter of credit, and unless an earlier time is agreed to by the party to pay, payment of an instrument may be deferred without dishonor pending reasonable examination to determine whether it is properly payable, but payment must be made in any event before the close of business on the day of presentment. (1899, c. 733, s. 136; Rev., s. 2286; C. S., s. 3118; 1965, c. 700, s. 1.)

**Acceptance of Checks.**—Under the NIL, a check was an order to the bank on which it was drawn to pay the amount thereof and charge it to the drawer's account. In respect of a check the bank on which it was drawn was the drawee; and, when

*Subsection (2):* Time for presentment may be extended in some cases. Further study may indicate a need for revision as regards the relation between GS 25-3-502, 25-3-503, 25-3-511 and this subsection.

presented to the drawee, the provisions of the NIL, as to time allowed the drawee to accept applied. *Branch Banking & Trust Co. v. Bank of Washington*, 255 N.C. 205, 120 S.E.2d 830 (1961).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 136, Uniform Negotiable Instruments Law.

**Changes:** Expanded.

**Purposes of changes:** The original section covered only the time allowed to the drawee on presentment for acceptance. This section also covers the time allowed on presentment for payment.

Section 5—112 (Time allowed for honor) states the time, longer than here provided, during which a bank to which drafts are presented under a letter of credit may defer payment or acceptance without dishonor of the drafts. As to drafts drawn under a letter of credit Section 5—112 of course controls.

Section 4—301 on deferred posting should be consulted for the right of a payor bank to recover tentative settlements made by it on the day an item is received. That right does not survive final payment (Section 4—213).

**Cross references:**

Sections 4—301 and 5—112.

**Definitional cross references:**

"Acceptance". Section 3—410.

"Dishonor". Section 3—507.

"Documentary draft". Sections 3—102 and 4—104.

"Instrument". Section 3—102.

"Letter of credit". Section 5—103.

"Party". Section 1—201.

"Presentment". Section 3—504.

## NORTH CAROLINA COMMENT

This section gives a little extra time for a party to whom an instrument is presented for payment or acceptance to decide what action he will take.

Also relevant to the time for action are:

GS 25-5-112—Time allowed for honor under letter of credit.

GS 25-4-301—Recovery by bank of tentative settlements.

**§ 25-3-507. Dishonor; holder's right of recourse; term allowing re-presentment.**—(1) An instrument is dishonored when

(a) a necessary or optional presentment is duly made and due acceptance or payment is refused or cannot be obtained within the prescribed time or in case of bank collections the instrument is seasonably returned by the midnight deadline (§ 25-4-301); or

(b) presentment is excused and the instrument is not duly accepted or paid.

(2) Subject to any necessary notice of dishonor and protest, the holder has upon dishonor an immediate right of recourse against the drawers and indorsers.

(3) Return of an instrument for lack of proper indorsement is not dishonor.

(4) A term in a draft or an indorsement thereof allowing a stated time for presentment in the event of any dishonor of the draft by nonacceptance if a time draft or by nonpayment if a sight draft gives the holder as against any secondary party bound by the term an option to waive the dishonor without affecting the liability of the secondary party and he may present again up to the end of the stated time. (1899, c. 733, ss. 83, 149; Rev., ss. 2232, 2299; C. S., ss. 3064, 3131; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 83 and 149, Uniform Negotiable Instruments Law.

**Changes:** Reworded.

**Purposes of changes:**

1. The language of the section is changed in accordance with the provisions of the preceding section as to the time allowed for acceptance or payment

2. Subsection (3) is new. It states general banking and commercial understanding. The time within which a payor bank must return items, and the methods of returning, are stated in Section 4-301. Under Section 3-411(3) a bank may certify an item so returned.

**Cross references:**

Point 1: Sections 3-503, 3-504, 3-505, 3-508 and 4-301.

Point 2: Sections 3-411(3), 4-301.

**Definitional cross references:**

"Acceptance". Section 3-410.

"Bank". Section 1-201.

"Draft". Section 3-104.

"Holder". Section 1-201.

"Instrument". Section 3-102.

"Midnight deadline". Section 4-104.

"Notice of dishonor". Section 3-508.

"Presentment". Section 3-504.

"Protest". Section 3-509.

"Right". Section 1-201.

"Seasonably". Section 1-204.

"Secondary party". Section 3-102.

"Term". Section 1-201.

#### NORTH CAROLINA COMMENT

This section rewords the prior statutes.

It appears that subsection (2) may have some influence on GS 25-3-112 (accrual of cause of action).

Subsection (3) is new. See Official Comment 2.

**§ 25-3-508. Notice of dishonor.**—(1) Notice of dishonor may be given to any person who may be liable on the instrument by or on behalf of the holder or any party who has himself received notice, or any other party who can be compelled to pay the instrument. In addition an agent or bank in whose hands the instrument is dishonored may give notice to his principal or customer or to another agent or bank from which the instrument was received.

(2) Any necessary notice must be given by a bank before its midnight deadline and by any other person before midnight of the third business day after dishonor or receipt of notice of dishonor.

(3) Notice may be given in any reasonable manner. It may be oral or written and in any terms which identify the instrument and state that it has been dishonored. A misdescription which does not mislead the party notified does not vitiate the notice. Sending the instrument bearing a stamp, ticket or writing stating that acceptance or payment has been refused or sending a notice of debit with respect to the instrument is sufficient.

(4) Written notice is given when sent although it is not received.

(5) Notice to one partner is notice to each although the firm has been dissolved.

(6) When any party is in insolvency proceedings instituted after the issue of the instrument notice may be given either to the party or to the representative of his estate.

(7) When any party is dead or incompetent notice may be sent to his last known address or given to his personal representative.

(8) Notice operates for the benefit of all parties who have rights on the instru-

ment against the party notified. (1899, c. 733, ss. 90 to 108; Rev., ss. 2240 to 2258, C. S., ss. 3072 to 3090; 1965, c. 700, s. 1.)

**Diligent Attempt to Notify Is Necessary.**—A holder of a dishonored bill must give notice to all indorsers, or make a diligent attempt to give this notice, if he does not know where the indorser resides. *Runyon v. Montfort*, 44 N.C. 371 (1853).

**Former Rule as to Time for Notice.**—A reasonable notice was one which was sent by the first post after the day of dishonor, and when there was a daily mail, this necessarily meant the next day, if the next day's mail did not leave before business hours. *Hubbard v. Troy*, 24 N.C. 134 (1841); *Denny v. Palmer*, 27 N.C. 610 (1845); *National Bank v. Bradley*, 117 N.C. 526, 23 S.E. 455 (1895).

**No Particular Form Is Required.**—The notice required by law to be given to an indorser is good if it be sufficient to put the indorser on inquiry; no particular form is required, and any person through whose hands a bill or note has passed may give notice to the drawer or his prior indorser of the dishonor of the bill, although the bill or note may not have been taken up by him at that time. *President, Directors & Co. of Bank v. Seawell*, 9 N.C. 560 (1823).

**Verbal notice is good if sufficient to put indorsers upon inquiry.** *President, Directors & Co. of Bank v. Seawell*, 9 N.C. 560 (1823).

**Notice sent to the place where the bill was drawn is not sufficient.** *Denny v. Palmer*, 27 N.C. 610 (1845).

**Requirement of Sending to Nearest Post Office.**—The rule that notice to a distant indorser should be sent to the post office nearest to his residence was founded on the presumption that the information would most speedily be given in such way; but the rule is subject to modification, and the true inquiry is, was the notice directed to that post office which was most likely to impart to the indorser the earliest intelligence, though it may not be the nearest; if it was, it is sufficient. *President, Directors & Co. of Bank v. Lane*, 10 N.C. 453 (1825).

**The burden is on the holder to show that notice of nonpayment was given** the indorsers of a negotiable note, and in the absence of evidence of such notice to an indorser, or to his personal representative after his death, the holder is not entitled to recover on the indorsement. *Williams v. Fowler Auto. Co.*, 207 N.C. 309, 176 S.E. 567 (1934).

**Sufficient Proof of Notice.**—It has been held that evidence that the letter containing notice was put into the post office, directed to the defendant at his place of residence, was sufficient proof of the notice to be left to the jury, and that it was unnecessary to give notice to the defendant to produce the letter before parol evidence could be admitted. *Faribault v. Ely*, 13 N.C. 67 (1828).

## OFFICIAL COMMENT

Prior uniform statutory provision: Sections 90 through 108, Uniform Negotiable Instruments Law

**Changes.** Combined and simplified.

**Purposes of changes:** To simplify notice of dishonor and eliminate many of the detailed requirements of the original Act:

1. Notice is normally given by the holder or by an indorser who has himself received notice. Subsection (1) is intended to encourage and facilitate notice of dishonor by permitting any party who may be compelled to pay the instrument to notify any party who may be liable on it. Thus an indorser may notify another indorser who is not liable to the one who gives notice, even when the latter has not received notice from any other party to the instrument.

2. Except as to collecting banks, as to whom Section 4—212 controls, the time within which necessary notice must be given is extended to three days after dis-

honor or receipt of notice from another party. In the case of individuals the one-day time limit of the original Act has proved too short in many cases. It is extended to give the party a margin of time within which to ascertain what is required of him and get out an ordinary business letter. This time leeway eliminates the elaborate provisions as to the time of mailing in the original Sections 103 and 104.

3. Subsection (3) retains the substance of the original Sections 95 and 96. The provision approves the bank practice of returning the instrument bearing a stamp, ticket or other writing, or a notice of debit of the account, as sufficient notice. Subsection (4) retains the substance of the original Section 105.

4. Subsection (7) permits notice to be sent to the last known address of a party who is dead or incompetent rather than to his personal representative. The provision is intended to save time, as the name



of the personal representative often cannot easily be ascertained, and mail addressed to the original party will reach the representative.

**Cross references:**

Sections 3—501, 3—507 and 3—511.

Point 2: Section 4—212.

**Definitional cross references:**

“Acceptance”. Section 3—410.

“Bank”. Section 1—201.

“Customer”. Section 4—104.

“Dishonor”. Section 3—507.

“Holder”. Section 1—201.

“Insolvency proceedings”. Section 1—201.

“Instrument”. Section 3—102.

“Issue”. Section 3—102.

“Midnight deadline”. Section 4—104.

“Notifies”. Section 1—201.

“Party”. Section 1—201.

“Person”. Section 1—201.

“Representative”. Section 1—201.

“Rights”. Section 1—201.

“Send”. Section 1—201.

“Written” and “writing”. Section 1—201.

### NORTH CAROLINA COMMENT

This section brings together in one section some nineteen sections of the NIL dealing with notice of dishonor. It eliminates many of the detailed requirements of the NIL.

Only one North Carolina case was de-

cided on this matter under the NIL. *Piedmont Carolina Ry. v. Shaw*, 223 Fed. 973 (4th Cir. 1915), held notice of dishonor to one indorser was binding on other indorsers who discussed the matter among themselves.

§ 25-3-509. **Protest; noting for protest.**—(1) A protest is a certificate of dishonor made under the hand and seal of a United States consul or vice consul or a notary public or other person authorized to certify dishonor by the law of the place where dishonor occurs. It may be made upon information satisfactory to such person.

(2) The protest must identify the instrument and certify either that due presentment has been made or the reason why it is excused and that the instrument has been dishonored by nonacceptance or nonpayment.

(3) The protest may also certify that notice of dishonor has been given to all parties or to specified parties.

(4) Subject to subsection (5) any necessary protest is due by the time that notice of dishonor is due.

(5) If, before protest is due, an instrument has been noted for protest by the officer to make protest, the protest may be made at any time thereafter as of the date of the noting. (1899, c. 733, ss. 153, 156, 158, 160; Rev., ss. 2303, 2306, 2308, 2310; C. S., ss. 3135, 3138, 3140, 3142; 1965, c. 700, s. 1.)

**Protest of Inland Bills Was Not Necessary.**—Protest of an order or inland bill was not necessary to enable the holder to recover the principal and interest. Notice in due time of nonacceptance or nonpayment was all that was required for that purpose. *Hubbard v. Troy*, 24 N.C. 134 (1841); *Peoples Nat'l Bank v. Lutterloh*, 95 N.C. 495 (1886); *National Bank v. Bradley*, 117 N.C. 526, 23 S.E. 455 (1895).

**Nor Was Protest of Note Drawn in Another State.**—A promissory note made in another state need not be protested before the owner may sue an indorser, there being no evidence that this is required in the state where the note was executed. *State Bank v. Carr*, 130 N.C. 479, 41 S.E. 876 (1902).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 153, 154, 155, 156, 158 and 160, Uniform Negotiable Instruments Law.

**Changes:** Combined and simplified.

**Purposes of changes:**

1. Protest is not necessary except on drafts drawn or payable outside of the United States. Section 3—501(3) which also permits the holder at his option to make protest on dishonor of any other instrument. This section is intended to simplify

either necessary or optional protest when it is made.

2. “Protest” has been used to mean the act of making protest, and sometimes loosely to refer to the entire process of presentment, notice of dishonor and protest. In this Article it is given its original, technical meaning, that of the official certificate of dishonor.

3. Subsection (1) adds to the notary public the United States consul or vice

consul, and any other person authorized to certify dishonor by the law of the place where dishonor occurs. It eliminates the requirement of the original Section 156 that protest must be made at the place of dishonor. It eliminates also the provision of the original Section 154 permitting protest by "any respectable resident of the place where the bill is dishonored, in the presence of two or more credible witnesses." This has at least left uncertainty as to the identity and credibility of the persons certifying, and has almost never been used. Any necessary delay in finding the proper officer to make protest is excused under Section 3—511.

4. "Information satisfactory to such person" does away with the requirement occasionally stated, that the person making protest must certify as of his own knowledge. The requirement has been more honored in the breach than in the observance, and in practice protest has been made upon hearsay which the officer regards as reliable, upon the admission of the person who has dishonored, or at most upon re-presentment which is only indirect proof of the original dishonor. There is seldom any possible motive for false protest, and the basis on which it is made is never questioned. Subsection (1) leaves to the certifying officer the responsibility for determining whether he has satisfactory information. The provision is not intended to affect any personal liability of the officer for making a false certificate.

5. The protest need not be in any particular form, so long as it certifies the matters stated in Subsection (2). It need not be annexed to the instrument, and may be forwarded separately, but annexation may identify the instrument. If the instrument

is lost, destroyed, or wrongfully withheld, protest is still sufficient if it identifies the instrument; but the owner must prove his rights as in any action under this Article on a lost, destroyed or stolen instrument (Section 3—804).

6. Subsection (3) recognizes the practice of including in the protest a certification that notice of dishonor has been given to all parties or to specified parties. The next section makes such a certification presumptive evidence that the notice has been given.

7. Protest is normally forwarded with notice of dishonor. Subsection (4) extends the time for making a necessary protest to coincide with the time for giving notice of dishonor. Any delay due to circumstances beyond the holder's control is excused under Section 3—511 on waiver or excuse. Any protest which is not necessary but merely optional with the holder may be made at any time before it is used as evidence.

8. Subsection (5) retains from the original Section 155 the provision permitting the officer to note the protest and extend it formally later.

#### Cross references:

- Point 1: Sections 3—501(3) and 3—511.
- Point 3: Section 3—511(1).
- Point 5: Section 3—804.
- Point 6: Section 3—510(a).
- Point 7: Sections 3—508(2) and 3—511(1).

#### Definitional cross references:

- "Dishonor". Section 3—507.
- "Instrument". Section 3—102.
- "Notice of dishonor". Section 3—508.
- "Party". Section 1—201.
- "Person". Section 1—201.
- "Presentment". Section 3—504.

### NORTH CAROLINA COMMENT

This simplifies the mechanics of protest, drafts drawn or payable outside the United States. and protest is not necessary except on States.

§ 25-3-510. Evidence of dishonor and notice of dishonor. — The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor therein shown:

(a) a document regular in form as provided in the preceding section [§ 25-3-509] which purports to be a protest;

(b) the purported stamp or writing of the drawee, payor bank or presenting bank on the instrument or accompanying it stating that acceptance or payment has been refused for reasons consistent with dishonor;

(c) any book or record of the drawee, payor bank, or any collecting bank kept in the usual course of business which shows dishonor, even though there is no evidence of who made the entry. (1965, c. 700, s. 1.)

**Protest as Evidence under Former Law.** —By the law merchant a protest of a bill by a public notary was, in itself, evidence.

And by statute such protest was prima facie evidence. *Gordon v. Price*, 32 N.C. 385 (1849).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** This section is new. It states the effect of protest as evidence, and provides two substitutes for protest as proof of dishonor:

1. Paragraph (a) states the generally accepted rule that a protest is not only admissible as evidence, but creates a presumption, as that term is defined in this Act (Section 1-201), of the dishonor which it certifies. The rule is extended to include the giving of any notice of dishonor certified by the protest. The provision also relieves the holder of the necessity of proving that a document regular in form which purports to be a protest is authentic, or that the person making it was qualified. Nothing in the provision is intended to prevent the obligor from overthrowing the presumption by evidence that there was in fact no dishonor, that notice was not given, or that the protest is not authentic or not made by a proper officer.

2. Paragraph (b) recognizes as the full equivalent of protest the stamp, ticket or other writing of the drawee, payor or presenting bank. The drawee's statement that payment is refused on account of insufficient funds always has been commercially acceptable as full proof of dishonor. It should be satisfactory evidence in any court. It is therefore made admissible, and creates a presumption of dishonor. The provision applies only where the stamp or writing states reasons for refusal which are consistent with dishonor. Thus the following reasons for refusal are not evidence of dishonor, but of justifiable refusal to pay or accept:

Indorsement missing  
Signature missing

Signature illegible  
Forgery  
Payee altered  
Date altered  
Post dated  
Not on us

On the other hand the following reasons are satisfactory evidence of dishonor, consistent with due presentment, and are within this provision:

Not sufficient funds  
Account garnished  
No account  
Payment stopped

3. Paragraph (c) recognizes as the full equivalent of protest any books or records of the drawee, payor bank or any collecting bank kept in its usual course of business, even though there is no evidence of who made the entries. The provision, as well as that of paragraph (b), rests upon the inherent improbability that bank records, or those of the drawee, will show any dishonor which has not in fact occurred, or that the holder will attempt to proceed on the basis of dishonor if he could in fact have obtained payment.

**Cross references:**

Sections 3-501 and 3-508.

Point 1: Section 1-201.

**Definitional cross references:**

"Acceptance". Section 3-410.

"Collecting bank". Section 4-105.

"Dishonor". Section 3-507.

"Instrument". Section 3-102.

"Notice of dishonor". Section 3-508.

"Payor bank". Section 4-105.

"Presumption". Section 1-201.

"Protest". Section 3-509.

"Writing". Section 1-201.

## NORTH CAROLINA COMMENT

Herein are stated some rules of evidence of proper dishonor and notice of dishonor. This new section helps clarify North Carolina rules of evidence on this limited subject.

The Official Comments adequately explain the section.

**§ 25-3-511. Waived or excused presentment, protest or notice of dishonor or delay therein.**—(1) Delay in presentment, protest or notice of dishonor is excused when the party is without notice that it is due or when the delay is caused by circumstances beyond his control and he exercises reasonable diligence after the cause of the delay ceases to operate.

(2) Presentment or notice or protest as the case may be is entirely excused when

(a) the party to be charged has waived it expressly or by implication either before or after it is due; or

(b) such party has himself dishonored the instrument or has countermanded payment or otherwise has no reason to expect or right to require that the instrument be accepted or paid; or



(c) by reasonable diligence the presentment or protest cannot be made or the notice given.

(3) Presentment is also entirely excused when

(a) the maker, acceptor or drawee of any instrument except a documentary draft is dead or in insolvency proceedings instituted after the issue of the instrument; or

(b) acceptance or payment is refused but not for want of proper presentment.

(4) Where a draft has been dishonored by nonacceptance a later presentment for payment and any notice of dishonor and protest for nonpayment are excused unless in the meantime the instrument has been accepted.

(5) A waiver of protest is also a waiver of presentment and of notice of dishonor even though protest is not required.

(6) Where a waiver of presentment or notice or protest is embodied in the instrument itself it is binding upon all parties; but where it is written above the signature of an indorser it binds him only. (1899, c. 733, ss. 79 to 82, 109 to 116, 130, 147, 148, 151, 159; Rev., ss. 2228 to 2231, 2259 to 2266, 2280, 2297, 2298, 2301, 2309; C. S., ss. 3060 to 3063, 3091 to 3098, 3112, 3129, 3130, 3133, 3141; 1965, c. 700, s. 1.)

**Cross Reference.**—See note to § 25-3-501.

**Knowledge of Insolvency of Drawee Does Not Excuse Presentment and Notice.**

—The drawers, having funds in the hands of the drawee, had the right to expect their bill to be honored by them, and they were entitled to presentment of their bill in a reasonable time and strict notice if dishonored on the part of the plaintiff, although the drawers at the time they drew the bill may have believed the drawees were insolvent and had been so notified by them and requested not to draw on them. *Cedar Falls Co. v. Wallace Bros.*, 83 N.C. 225 (1880).

**Nor Does Belief Maker Will Not Pay Note.**—Although, at the time of the indorsement of a note, the indorsers had reason to believe, and did believe, that the note would not be paid by the maker, this circumstance does not dispense with the necessity of a due notice. *Denny v. Palmer*, 27 N.C. 610 (1845).

**But Presentment Is Unnecessary to Charge Treasurer of Corporation without Funds.**—Where the treasurer of a corporation indorses the corporate note, payable at a certain bank, and at its maturity the corporation has no funds at the bank, it is not necessary that the note should have been presented to the bank for payment. *Meyers Co. v. Battle*, 170 N.C. 168, 86 S.E. 1034 (1915).

**Delay Caused by One Liable Is Excuse.**—Where an agent has incurred a personal liability on a negotiable instrument given in behalf of his principal, he may not avoid payment on the ground of delay in presenting it for payment, when the delay was at his own request and by his own conduct. *Caldwell County v. George*, 176 N.C. 602, 97 S.E. 507 (1918).

**And Where Presentment Cannot Be Made, It Is Unnecessary.**—Where the maker is a seaman, without any domicile in the State, and goes on a voyage about the time the note falls due, no demand on him is necessary in order to charge the indorser. *Moore v. Coffield*, 12 N.C. 247 (1827).

**Waiver of Protest Waives Presentment and Notice.**—In foreign bills the protest may be waived; the words, "I waive protest," or "waiving protest," or any similar words, infer that the protest is waived, and when applied to foreign bills, are universally regarded as expressly waiving presentment and notice, the protest being, according to the law merchant, the formal and necessary evidence of the dishonor of such an instrument. *Shaw Bros. v. McNeill*, 95 N.C. 535 (1886).

Although protest is not necessary on an inland bill, yet its waiver in such a case is construed to signify as much as when applied to foreign bills. *Shaw Bros. v. McNeill*, 95 N.C. 535 (1886).

**As Does Advance Consent to Extension.**—The authorities seem to hold that where the indorser consents in advance of maturity to extensions of the time of payment of the note, he thereby waives his right to receive notice of dishonor and presentment for payment. *National Bank v. Johnston*, 169 N.C. 526, 86 S.E. 360 (1915). See *Davis v. Royal*, 204 N.C. 147, 167 S.E. 559 (1933).

**Or Promise to Pay after Failure to Be Notified.**—A promise to pay generally, or a promise to pay a part, or a part payment made, with a full knowledge that he had been fully released from liability on the bill by the neglect of the holder to give notice, will operate as a waiver and bind the party who makes it for the

payment of the whole bill. *Shaw Bros. v. McNeill*, 95 N.C. 535 (1886).

Where, upon the dishonor of a bill of exchange or promissory note, the indorsee has neglected to give the proper notice, the drawer or indorser of the bill or indorser of the note will still be liable, if, after a knowledge of all the facts which in law would have discharged him, he promises to pay the bill or note. *Moore v. Tucker*, 25 N.C. 347 (1843).

**But Waiver of Notice Is Insufficient If There Was No Presentment.**—When one, thinking there has been a presentment for payment, makes promises that would amount to a waiver, had there been a presentment, he is not liable on the grounds of waiver of notice if there had been no presentment for payment. *Lilly v. Pette-way*, 73 N.C. 358 (1875).

**Indorser Is Bound by Waiver on Face of Instrument.**—Where upon the face of a negotiable note there is an agreement to waive notice of dishonor or an extension of time, etc., one placing his name on the back thereof is deemed to be an indorser without indication of other liability therein, and is bound by the agreement expressed on the face of the instrument waiving notice, etc. *Gillam v. Walker*, 189 N.C. 189, 126 S.E. 424 (1925).

An extension of time for payment of a note will not discharge an indorser when the note provides on its face that extension of time for payment is waived by all parties to the note, the indorser being a "party" to the note. *Vannoy v. Stafford*, 209 N.C. 748, 184 S.E. 482 (1936).

**Waiver Held Not to Bind Former Part-**

**ner.**—Where a partner, after the dissolution of the firm, gives a draft in payment of a partnership debt, he cannot waive protest so as to bind his former copartner, especially when the latter has been a dormant member. *Mauney & Son v. Coit*, 80 N.C. 300 (1879).

**Implied Waiver of Immediate Presentment.**—Where a check was given for county bonds and the bonds could not be issued at once, and the drawer cooperated with the county to get the bond issue, there is a sufficient implied waiver of immediate presentment, and a presentment within a reasonable time after the bond issue was sufficient to bind the drawer. *Caldwell County v. George*, 176 N.C. 602, 97 S.E. 507 (1918).

**Option to Treat Bill as Bill or Note.**—Under the NIL, a paper coming directly within the definition of an inland bill of exchange could be treated as a bill or note at the option of the holder, the drawer and drawee being the same person. *Sherrill v. American Trust Co.*, 176 N.C. 591, 97 S.E. 471 (1918).

**Burden of Proof on Holder.**—If it is in fact an accommodation paper, then, notwithstanding the form of the paper, the drawer would be primarily liable and not entitled to notice, but the burden to show this is on the holder, and there being no evidence to that fact, the form of the paper governs and the drawer is entitled to notice. *National Bank v. Bradley*, 117 N.C. 526, 23 S.E. 455 (1895). See *Hyde v. Tatham*, 204 N.C. 160, 167 S.E. 626 (1933).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 79, 80, 81, 82, 109, 111, 112, 113, 114, 115, 116, 130, 147, 148, 150, 151 and 159, Uniform Negotiable Instruments Law.

**Changes:** Combined and simplified.

**Purposes of changes:** This section combines widely scattered sections of the original Act, and is intended to simplify the rules as to when presentment, notice or protest is excused:

1. The single term "excused" is substituted for "excused," "dispensed with," "not necessary," "not required," as used variously in the original Act. No change in meaning is intended.

2. Subsection (1) combines provisions found in the original Sections 81, 113, 147 and 159. Delay in making presentment either for payment or for acceptance, in giving notice of dishonor or in making protest is excused when the party has acted

with reasonable diligence and the delay is not his fault. This is true where an instrument has been accelerated without his knowledge, or demand has been made by a prior holder immediately before his purchase. It is true under any other circumstances where the delay is beyond his control. The words "not imputable to his default, misconduct or negligence" found in the original Sections 81, 113 and 159 are omitted as superfluous, but no change in substance is intended.

3. Any waived presentment, notice or protest is excused, as under the original Sections 82, 109, 110 and 111. The waiver may be express or implied, oral or written, and before or after the proceeding waived is due. It may be, and often is, a term of the instrument when it is issued. Subsection (5) retains as standard commercial usage the meaning attached by the original Section 111 to "protest waived."

4. Paragraph (b) of subsection (2) combines the substance of provisions found in the original Sections 79, 80, 114, 115 and 130. A party who has no right to require or reason to expect that the instrument will be honored is not entitled to presentment, notice or protest. This is of course true where he has himself dishonored the instrument or has countermanded payment. It is equally true, for example, where he is an accommodated party and has himself broken the accommodation agreement.

5. Paragraph (c) of subsection (2) combines provisions found in the original Sections 82(1), 112 and 159. The excuse is established only by proof that reasonable diligence has been exercised without success, or that reasonable diligence would in any case have been unsuccessful.

6. Paragraph (a) of subsection (3) is new. It excuses presentment in situations where immediate payment or acceptance is impossible or so unlikely that the holder cannot reasonably be expected to make presentment. He is permitted instead to have his immediate recourse upon the drawer or indorser, and let the latter file any necessary claim in probate or insolvency proceedings. The exception for the documentary draft is to preserve any profit on the resale of goods for the creditors of the drawee if his representative can find the funds to pay.

7. Paragraph (b) of subsection (3) extends the original Section 148(3) to include any case where payment or acceptance is definitely refused and the refusal is not on the ground that there has been no proper presentment. The purpose of presentment is to determine whether or not the maker, acceptor or drawee will pay or accept; and when that question is clearly determined the holder is not required to go through a useless ceremony. The provision applies to a definite refusal stating no reasons.

8. Subsection (4) retains the rule of the original Sections 116 and 151.

9. Subsection (6) retains the rule of original Section 110.

**Cross references:**

Sections 3—501, 3—502, 3—503, 3—507 and 3—509.

**Definitional cross references:**

"Acceptance". Section 3—410.

"Dishonor". Section 3—507.

"Documentary draft". Section 4—104.

"Draft". Section 3—104.

"Insolvency proceedings". Section 1—201.

"Instrument". Section 3—102.

"Issue". Section 3—102.

"Notice of dishonor". Section 3—508.

"Party". Section 1—201.

"Presentment". Section 3—504.

"Protest". Section 3—509.

"Right". Section 1—201.

### NORTH CAROLINA COMMENT

Many sections of the NIL are brought together in one place, and the rules of "excuse" are simplified.

Note that "excused" used alone (subsection (1)) means temporary excuse; while "entirely excused" (subsections (2) and

(3)) means that presentment, protest and notice are not required at all in some cases.

In commercial practice this section will be quite important; and the Official Comments should be examined.

## PART 6.

### DISCHARGE.

§ 25-3-601. **Discharge of parties.**—(1) The extent of the discharge of any party from liability on an instrument is governed by the sections on

- (a) payment or satisfaction (§ 25-3-603); or
- (b) tender of payment (§ 25-3-604); or
- (c) cancellation or renunciation (§ 25-3-605); or
- (d) impairment of right of recourse or of collateral (§ 25-3-606); or
- (e) reacquisition of the instrument by a prior party (§ 25-3-208); or
- (f) fraudulent and material alteration (§ 25-3-407); or
- (g) certification of a check (§ 25-3-411); or
- (h) acceptance varying a draft (§ 25-3-412); or
- (i) unexcused delay in presentment or notice of dishonor or protest (§ 25-3-502).

(2) Any party is also discharged from his liability on an instrument to another party by any other act or agreement with such party which would discharge his simple contract for the payment of money.



(3) The liability of all parties is discharged when any party who has himself no right of action or recourse on the instrument

(a) reacquires the instrument in his own right; or

(b) is discharged under any provision of this article, except as otherwise provided with respect to discharge for impairment of recourse or of collateral (§ 25-3-606). (1899, c. 733, ss. 119 to 121; Rev., ss. 2269 to 2271; C. S., ss. 3101 to 3103; 1965, c. 700, s. 1.)

**Act Discharging Simple Contract.**—An instruction that a negotiable instrument may be discharged by an act which would discharge a simple contract for the payment of money was not error under the *NIL. Hood System Industrial Bank v. Dixie Oil Co.*, 205 N.C. 778, 172 S.E. 360 (1934).

**Compromise Payment by Surety.**—When the liability of a surety or accommodation indorser is discharged by compromise and settlement, the maker is entitled to credit only for the amount actually paid. *First & Citizens Nat'l Bank v. Hinton*, 216 N.C. 159, 4 S.E.2d 332 (1939).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 119, 120 and 121, Uniform Negotiable Instruments Law.

**Changes:** Portions of original sections combined and reworded; new provisions.

### Purposes of changes:

1. Subsection (1) contains an index referring to all of the sections of this Article which provide for the discharge of any party. The list is exclusive so far as the provisions of this Article are concerned, but it is not intended to prevent or affect any discharge arising apart from this statute, as for example a discharge in bankruptcy or a statutory provision for discharge if the instrument is negotiated in a gaming transaction.

2. A negotiable instrument is in itself merely a piece of paper bearing a writing, and strictly speaking is incapable of being discharged. The parties are rather discharged from liability on their contracts on the instrument. The language of the original Section 119 as to discharge of the instrument itself has left uncertainties as to the effect of the discharge upon the rights of a subsequent holder in due course. It is therefore eliminated, and this section now distinguishes instead between the discharge of a single party and the discharge of all parties.

So far as the discharge of any one party is concerned a negotiable instrument differs from any other contract only in the special rules arising out of its character to which paragraphs (a) to (i) of subsection (1) are an index, and in the effect of the discharge against a subsequent holder in due course (Section 3—602). Subsection (2) therefore retains from the original Section 119(4) the provision for discharge by "any other act which will discharge a simple contract for the payment of money," and specifically recognizes the possibility of a discharge by agreement.

The discharge of any party is a defense available to that party as provided in sections on rights of those who are and are not holders in due course (Sections 3—305 and 3—306). He has the burden of establishing the defense (Section 3—307).

3. Subsection (3) substitutes for the "discharge of the instrument" the discharge of all parties from liability on their contracts on the instrument. It covers a part of the substance of the original Section 119(1), (2) and (5), the original Section 120(1) and (3), and the original Section 121(1) and (2). It states a general principle in lieu of the original detailed provisions. The principle is that all parties to an instrument are discharged when no party is left with rights against any other party on the paper.

When any party reacquires the instrument in his own right his own liability is discharged; and any intervening party to whom he was liable is also discharged as provided in Section 3—208 on reacquisition. When he is left with no right of action against an intervening party and no right to recourse against any prior party, all parties are obviously discharged. The instrument itself is not necessarily extinct, since it may be reissued or renegotiated with a new and further liability; and if it subsequently reaches the hands of a holder in due course without notice of the discharge he may still enforce it as provided in Section 3—602 on effect of discharge against a holder in due course.

Under Section 3—606 on impairment of recourse or collateral, the discharge of any party discharges those who have a right of recourse against him, except in the case of a release with reservation of rights or a failure to give notice of dishonor. A discharge of one who has himself no right of action or recourse on the instrument may thus discharge all parties. Again the

instrument itself is not necessarily extinct, and if it is negotiated to a subsequent holder in due course without notice of the discharge he may enforce it as provided in Section 3-602 on effect of discharge against a holder in due course.

4. The language "any party who has himself no right of action or recourse on the instrument" is substituted for "principal debtor," which is not defined by the original Act and has been misleading. This Article also omits the original Section 192, defining the "person primarily liable." Under Section 3-415 on accommodation parties an accommodation maker or acceptor, although he is primarily liable on the instrument in the sense that he is obligated to pay it without recourse upon another, has himself a right of recourse against the accommodated payee; and his reacquisition or discharge leaves the accommodated party liable to him. The accommodated payee, although he is not primarily liable to others, has no right of action or recourse against the accommoda-

tion maker, and his reacquisition or discharge may discharge all parties.

#### Cross references:

Sections 3-406, 3-411, 3-412, 3-509, 3-603, 3-604 and 3-605.

Point 2: Sections 3-305, 3-306, 3-307 and 3-602.

Point 3: Sections 3-208, 3-602 and 3-606.

Point 4: Section 3-415.

#### Definitional cross references:

"Action". Section 1-201.

"Agreement". Section 1-201.

"Alteration". Section 3-407.

"Certification". Section 3-411.

"Check". Section 3-104.

"Contract". Section 1-201.

"Draft". Section 3-104.

"Instrument". Section 3-102.

"Money". Section 1-201.

"Notice of dishonor". Section 3-508.

"Party". Section 1-201.

"Presentment". Section 3-504.

"Rights". Section 1-201.

### NORTH CAROLINA COMMENT

The various sections dealing with discharge of a party from "liability on an instrument" are widely scattered throughout article 3. Subsection (1) contains an index to these sections.

Subsection (2) provides for a discharge between parties who deal with each other, but this does not mean that a party will be discharged as against those with whom he is not dealing. See also GS 25-3-602.

Subsection (3) provides for the discharge

of all parties in some situations. Formerly, this was spoken of as "discharge of the instrument."

Since discharge is an important aspect of negotiable instruments, the Official Comments should be consulted.

See 29 N.C.L. Rev. 307 for note on effect of discharge of prior party by statute of limitations on guarantor or surety under the NIL.

**§ 25-3-602. Effect of discharge against holder in due course.**—No discharge of any party provided by this article is effective against a subsequent holder in due course unless he has notice thereof when he takes the instrument. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

#### Purposes:

The section is intended to remove an uncertainty as to which the original Act is silent. It rests on the principle that any discharge of a party provided under any section of this Article is a personal defense of the party, which is cut off when a subsequent holder in due course takes the instrument without notice of the defense. Thus where an instrument is paid without surrender such a subsequent purchase cuts off the defense. This section applies only to discharges arising under the provisions of this Article, and it has no application to any discharge arising apart from it, such as a discharge in bankruptcy.

Under Section 3-304(1) (b) on notice

to purchaser it is possible for a holder to take the instrument in due course even though he has notice that one or more parties have been discharged, so long as any party remains undischarged. Thus he may take with notice that an indorser of a note has been released, and still be a holder in due course as to the liability of the maker. In that event, the holder in due course is subject to the defense of the discharge of which he had notice when he took the instrument.

#### Cross references:

Sections 3-302, 3-304, 3-305 and 3-601.

#### Definitional cross references:

"Holder in due course". Section 3-302.

"Instrument". Section 3-102.

"Notice". Section 1-201.

"Party". Section 1-201.

## NORTH CAROLINA COMMENT

This short new section makes it clear that an HDC takes free of any discharge of which he has no notice when he takes the instrument.

One can be an HDC under GS 25-3-304

(1) (b) even though he knows of the discharge of some parties; but this section provides he cannot hold them liable on the instrument.

**§ 25-3-603. Payment or satisfaction.**—(1) The liability of any party is discharged to the extent of his payment or satisfaction to the holder even though it is made with knowledge of a claim of another person to the instrument unless prior to such payment or satisfaction the person making the claim either supplies indemnity deemed adequate by the party seeking the discharge or enjoins payment or satisfaction by order of a court of competent jurisdiction in an action in which the adverse claimant and the holder are parties. This subsection does not, however, result in the discharge of the liability

(a) of a party who in bad faith pays or satisfies a holder who acquired the instrument by theft or who (unless having the rights of a holder in due course) holds through one who so acquired it; or

(b) of a party (other than an intermediary bank or a payor bank which is not a depository bank) who pays or satisfies the holder of an instrument which has been restrictively indorsed in a manner not consistent with the terms of such restrictive indorsement.

(2) Payment or satisfaction may be made with the consent of the holder by any person including a stranger to the instrument. Surrender of the instrument to such a person gives him the rights of a transferee (§ 25-3-201). (1899, c. 733, ss. 55, 88, 119, 121, 171 to 177; Rev., ss. 2204, 2238, 2269, 2271, 2321 to 2327; C. S., ss. 3036, 3070, 3101, 3103, 3153 to 3159; 1965, c. 700, s. 1.)

**Indorser Can Only Recover Amount He Actually Pays.**—An indorser who pays off amount actually paid by him. *Pace v. Robertson*, 65 N.C. 550 (1871).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 51, 88, 119, 121 and 171—177, Uniform Negotiable Instruments Law.

**Changes:** Parts of original sections combined and reworded; law changed.

**Purposes of changes:** This section changes the law as follows:

1. It eliminates the "payment in due course" found in the original Sections 51, 88 and 119. "Payment in due course" discharged all parties, where it was made by one who has no right of recourse on the instrument; but this is true of any other discharge of such a party, and is now covered by Section 3—601(3) on discharge of parties. Such payment was effective as a discharge against a subsequent purchaser; but since it is made at or after maturity of the instrument a purchaser with notice of that fact cannot be a holder in due course, and one who takes without notice of the payment and the maturity should be protected against failure to take up the instrument. The matter is now covered by Section 3—602.

2. The original Sections 171—177 provide for payment of a draft "for honor" after protest. The practice originated at a time when communications were slow and dif-

icult, and in overseas transactions there might be a delay of several months before the drawer could act upon any dishonor. It provided a method by which a third party might intervene to protect the credit of the drawer and at the same time preserve his own rights. Cable, telegraph and telephone have made the practice obsolete for nearly a century, and it is today almost entirely unknown. It has been replaced by the cable transfer, the letter of credit and numerous other devices by which a substitute arrangement is promptly made. "Payment for honor" is therefore eliminated; and subsection (2) now provides that any person may pay with the consent of the holder.

3. Payment to the holder discharges the party who makes it from his own liability on the instrument, and a part payment discharges him pro tanto. The same is true of any other satisfaction. Subsection (1) changes the law by eliminating the requirement of the original Section 88 that the payment be made in good faith and without notice that the title of the holder is defective. It adopts as a general principle the position that a payor is not required to obey an order to stop



payment received from an indorser. However, this general principle is qualified by the provisions of subsection (1) (a) and (b) respecting persons who acquire an instrument by theft, or through a restrictive indorsement (Section 3—205). These provisions are thus consistent with Section 3—306 covering the rights of one not a holder in due course.

When the party to pay is notified of an adverse claim to the instrument he has normally no means of knowing whether the assertion is true. The “unless” clause of subsection (1) follows statutes which have been passed in many states on adverse claims to bank deposits. The paying party may pay despite notification of the adverse claim unless the adverse claimant supplies indemnity deemed adequate by the paying party or procures the issuance of process restraining payment in an action in which the adverse claimant and the holder of the instrument are both parties. If the paying party chooses to refuse payment and stand suit, even though not indemnified or enjoined, he is free to do so, although, under Section 3—306(d) on the rights of one not a holder in due course, except where theft or taking through a restrictive indorsement is alleged the payor must rely on the third party claimant to litigate the issue and may not himself defend on such a ground. His contract is to pay the holder of the instrument, and he performs cases of theft or restrictive indorsement there is no good reason to put him to it by making such payment. Except in inconvenience because of a dispute between two other parties unless he is indemnified or served with appropriate process.

4. With the elimination of “payment for honor”, subsection (2) provides that with the consent of the holder payment may be made by anyone, including a stranger. The subsection omits the provision of the original Section 121 by

which the payor is “remitted to his former rights”. It rejects such decisions as *Quimby v. Varnum*, 190 Mass. 211, 76 N.E. 671 (1906), holding that an irregular indorser who makes payment cannot recover on the instrument. The same result is reached under Section 3—415(5) on accommodation parties. Upon payment and surrender of the paper the payor succeeds to the rights of the holder, subject to the limitation found in Section 3—201 on transfer that one who has himself been a party to any fraud or illegality affecting the instrument or who as a prior holder had notice of a defense or claim against it cannot improve his position by taking from a later holder in due course.

5. Payment discharges the liability of the person making it. It discharges the liability of other parties only as

a. The discharge of the payor discharges others who have a right of recourse against him under Section 3—606; or

b. Reacquisition of the instrument discharges intervening parties under Section 3—208 on reacquisition; or

c. The discharge of one who has himself no right of recourse on the instrument discharges all parties under Section 3—601 on discharge of parties.

#### Cross references:

Sections 3—604 and 3—606.

Point 1: Section 3—601(3).

Point 3: Sections 3—205 and 3—306(d).

Point 4: Sections 3—201 and 3—415(5).

Point 5: Sections 3—606, 3—208, and 3—604.

#### Definitional cross references:

“Action”. Section 1—201.

“Holder”. Section 1—201.

“Instrument”. Section 3—102.

“Order”. Section 3—102.

“Party”. Section 1—201.

“Person”. Section 1—201.

“Rights”. Section 1—201.

### NORTH CAROLINA COMMENT

By this section several parts of the NIL are combined and reworded and some changes are made.

GS 25-178 to 25-184 on “payment for honor” have been eliminated as obsolete. There were no North Carolina cases under these sections.

Subsection (1) changes the law by eliminating the requirement of GS 25-95 (NIL 88) that in order for a payor to be discharged by payment he must pay at a time when he does not know of adverse claims to the instrument. By this sub-

section a payor is free to pay despite his knowledge of another's claims unless (1) the claimant supplies adequate indemnity to the payor or (2) the claimant enjoins payment. Thus, the burden of taking action to prevent payment is placed on the adverse claimant.

In two situations, however, a payor will not be discharged when he makes payment:

(a) When he in bad faith pays one who has taken through a thief (unless the taker has rights of HDC); or

(b) when certain parties pay contrary to a restrictive indorsement. See also GS 25-3-306.

Subsection (2) permits a stranger to pay

an instrument with the consent of the holder, and such payor gets the rights of a transferee (GS 25-3-201).

**§ 25-3-604. Tender of payment.**—(1) Any party making tender of full payment to a holder when or after it is due is discharged to the extent of all subsequent liability for interest, costs and attorney's fees.

(2) The holder's refusal of such tender wholly discharges any party who has a right of recourse against the party making the tender.

(3) Where the maker or acceptor of an instrument payable otherwise than on demand is able and ready to pay at every place of payment specified in the instrument when it is due, it is equivalent to tender. (1899, c. 733, ss. 70, 120; Rev., ss. 2219, 2270; C. S., ss. 3051, 3102; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 70 and 120, Uniform Negotiable Instruments Law.

**Changes:** Parts of original sections combined and reworded; new provisions.

**Purposes of changes and new matter:**

1. Subsection (1) is new. It states the generally accepted rule as to the effect of tender.

2. Subsection (2) rewords the original subsection 120(4). The party discharged is one who has a right of recourse against the party making tender, whether the latter be a prior party or a subsequent one who has been accommodated.

3. Subsection (3) rewords the final clause of the first sentence of the original Section 70. Where the instrument is payable at any one of two or more specified places, the maker or acceptor must be able and ready to pay at each of

them. The language in original Section 70 was taken to mean that makers and acceptors of notes and drafts payable at a bank were not discharged by failure of a holder to make due presentment of such paper at the designated bank. This Article reverses that rule. See Section 3—501 on necessity of presentment, 3—504 on how presentment is made, and 3—502 on effect of delay in presentment.

#### Cross references:

Section 3—601.

Point 3: Sections 3—501, 3—502 and 3—504.

#### Definitional cross references:

"Holder". Section 1—201.

"Instrument". Section 3—102.

"On demand". Section 3—108.

"Party". Section 1—201.

"Right". Section 1—201.

#### NORTH CAROLINA COMMENT

Subsection (1) is new. It discharges one who makes full tender to the extent of all subsequent liability for interest, costs and attorney's fees.

The provision regarding attorney's fees may be somewhat troublesome in North Carolina. Despite the probable North Carolina general rule that attorney's fees are not to be allowed as a part of costs, this section should be construed as written to save harmless any party who makes

a tender of full payment. See also North Carolina Comment to GS 25-3-106 (e).

Official Comments 2 and 3 adequately explain subsections (2) and (3).

See *Dry v. Reynolds*, 205 N.C. 571, 172 S.E. 351 (1934), which held a deposit in a bank sufficient to pay a note payable at a bank may be sufficient tender (but such tender would discharge only parties secondarily liable on note, and it would not discharge the maker and surety on note).

**§ 25-3-605. Cancellation and renunciation.**—(1) The holder of an instrument may even without consideration discharge any party

(a) in any manner apparent on the face of the instrument or the indorsement, as by intentionally cancelling the instrument or the party's signature by destruction or mutilation, or by striking out the party's signature; or

(b) by renouncing his rights by a writing signed and delivered or by surrender of the instrument to the party to be discharged.

(2) Neither cancellation nor renunciation without surrender of the instrument affects the title thereto. (1899, c. 733, ss. 48, 119, 120, 122, 123; Rev., ss. 2197,

2269, 2270, 2272, 2273; C. S., ss. 3029, 3101, 3102, 3104, 3105; 1965, c. 700, § 1.)

**Cross Reference.**—See note to § 25-3-208.

**Release Must Be Written.**—The right of an obligor to defend an action against himself on a negotiable note, under the provisions of the NIL, could be done by virtue thereof only as therein expressed when the release was in writing, and could not be shown when resting only by parol. *Manly v. Beam*, 190 N.C. 659, 130 S.E. 633 (1925).

**Unless Instrument Is Surrendered.**—No writing is necessary if the instrument is delivered to the person primarily liable thereon. *Hood System Industrial Bank v.*

*Dixie Oil Co.*, 205 N.C. 778, 172 S.E. 360 (1934).

**Acceptance of Note of Another Party and Surrender of Original.**—In an action on a note the maker and sureties may rely on the discharge of the note by the payee's acceptance of the note of another party in the sum due, and the payee's delivery to them of the papers on which defendants were bound, since this is an intentional cancellation by the payee, which is not required to be in writing. *Hood System Industrial Bank v. Dixie Oil Co.*, 205 N.C. 778, 172 S.E. 360 (1934).

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 48, 119(3), 120 (2), 122 and 123, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded.

**Purposes of changes:**

1. The original Act does not state how cancellation is to be effected, except as to striking indorsements under the original Section 48. It must be done in such a manner as to be apparent on the face of the instrument, and the methods stated, which are supported by the decisions, are exclusive.

2. Subsection (1) (b) restates the original Section 122. The provision as to "discharge of the instrument" is now covered by discharge, Section 3—601(3); that

as to subsequent holders in due course by Section 3—602 on effect of discharge against a holder in due course.

3. Subsection (2) is new. It is intended to make it clear that the striking of an indorsement, or any other cancellation or renunciation, does not affect the title.

**Cross references:**

Point 2: Sections 3—601 and 3—602.

**Definitional cross references:**

"Holder". Section 1—201.

"Instrument". Section 3—102.

"Party". Section 1—201.

"Rights". Section 1—201.

"Signature". Section 3—401.

"Signed". Section 1—201.

"Writing". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1) (a)* expands GS 25-54 (NIL 48) by stating additional methods by which a party may be discharged by acts done to or on the instrument. These listed methods are exclusive.

*Subsection (1) (b)* states that the parties may give and receive a written and signed renunciation. Apparently, an oral

renunciation may not be proved. This was the rule of GS 25-129. *Page Trust Co. v. Lewis*, 200 N.C. 286, 156 S.E. 504 (1931), held verbal renunciation is ineffectual.

See 32 N.C.L. Rev. 210 (1954) for note on renunciation by holder conditioned on holder's death.

**§ 25-3-606. Impairment of recourse or of collateral.**—(1) The holder discharges any party to the instrument to the extent that without such party's consent the holder

(a) without express reservation of rights releases or agrees not to sue any person against whom the party has to the knowledge of the holder a right of recourse or agrees to suspend the right to enforce against such person the instrument or collateral or otherwise discharges such person, except that failure or delay in effecting any required presentment, protest or notice of dishonor with respect to any such person does not discharge any party as to whom presentment, protest or notice of dishonor is effective or unnecessary; or

(b) unjustifiably impairs any collateral for the instrument given by or on behalf of the party or any person against whom he has a right of recourse.

(2) By express reservation of rights against a party with a right of recourse the holder preserves



(a) all his rights against such party as of the time when the instrument was originally due; and

(b) the right of the party to pay the instrument as of that time; and

(c) all rights of such party to recourse against others. (1899, c. 733, s. 120; Rev., s. 2270; C. S., s. 3102; 1965, c. 700, s. 1.)

**Extension of Time for Payment.**—In an action upon a negotiable instrument, the defendants on its face being joint makers, the mere fact that the plaintiff had told one of the defendants, without the knowledge of the other, “that he would take up and carry the note until fall,” was not an extension of payment for a “fixed and definite” period, which would operate as a release to such other from liability. *Roberston v. Spain*, 173 N.C. 23, 91 S.E. 361 (1917).

Where the face of a note contains an

agreement that the parties should remain bound notwithstanding any extension of time granted the maker, upon payment of interest by him, the indorsers remain liable although ignorant of such extensions and payments of interest by the maker, they being bound by their agreement in the note and the extension being supported by the necessary elements of certainty, mutuality and consideration. *Fidelity Bank v. Hessee*, 207 N.C. 71, 175 S.E. 826 (1934).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 120, Uniform Negotiable Instruments Law.

**Changes:** Reworded; new provisions.

**Purposes of changes and new matter:** To make it clear that:

1. The words “any party to the instrument” remove an uncertainty arising under the original section. The suretyship defenses here provided are not limited to parties who are “secondarily liable,” but are available to any party who is in the position of a surety, having a right of recourse either on the instrument or dehors it, including an accommodation maker or acceptor known to the holder to be so.

2. Consent may be given in advance, and is commonly incorporated in the instrument; or it may be given afterward. It requires no consideration, and operates as a waiver of the consenting party’s right to claim his own discharge.

3. The words “to the knowledge of the holder” exclude the latent surety, as for example the accommodation maker where there is nothing on the instrument to show that he has signed for accommodation and the holder is ignorant of that fact. In such a case the holder is entitled to proceed according to what is shown by the face of the paper or what he otherwise knows, and does not discharge the

surety when he acts in ignorance of the relation.

4. This section retains the right of the holder to release one party, or to postpone his time of payment, while expressly reserving rights against others. Subsection (2), which is new, states the generally accepted rule as to the effect of such an express reservation of rights which to be effective must be accompanied by notification to any party against whom rights are so reserved (subsection (3)).

5. Paragraph (b) of subsection (1) is new. The suretyship defense stated has been generally recognized as available to indorsers or accommodation parties. As to when a holder’s actions in dealing with collateral may be “unjustifiable”, the section on rights and duties with respect to collateral in the possession of a secured party (Section 9—207) should be consulted.

#### Cross reference:

Point 5: Section 9—207.

#### Definitional cross references:

“Agreement”. Section 1—201.

“Holder”. Section 1—201.

“Instrument”. Section 3—102.

“Notice of dishonor”. Section 3—508.

“Party”. Section 1—201.

“Person”. Section 1—201.

“Rights”. Section 1—201.

#### NORTH CAROLINA COMMENT

*Subsection (1) (a)* provides for the discharge of a party (secondary or surety) when without the party’s consent the holder releases certain third persons.

The “except” clause makes it clear that the release provisions apply to the release of a third party by inaction (failure or de-

lay in presentment, etc.) as well as to an active release or covenant not to sue.

*Subsection (1) (b)* gives a discharge in some cases when collateral is impaired.

*Subsection (2)* lists the rights that are preserved by an express reservation of rights.

The following North Carolina case is affirmed by this section: *Wolf Mountain Lumber Co. v. Buchanan*, 192 N.C. 771, 136 S.E. 129 (1926). Held: Where holder releases maker of note, he discharges indorsers.

See 29 N.C.L. Rev. 307 for note dealing with effect of discharge of prior party by statute of limitations on guarantor or surety on negotiable instrument.

## PART 7.

### ADVICE OF INTERNATIONAL SIGHT DRAFT.

§ 25-3-701. Letter of advice of international sight draft.—(1) A "letter of advice" is a drawer's communication to the drawee that a described draft has been drawn.

(2) Unless otherwise agreed when a bank receives from another bank a letter of advice of an international sight draft the drawee bank may immediately debit the drawer's account and stop the running of interest pro tanto. Such a debit and any resulting credit to any account covering outstanding drafts leaves in the drawer full power to stop payment or otherwise dispose of the amount and creates no trust or interest in favor of the holder.

(3) Unless otherwise agreed and except where a draft is drawn under a credit issued by the drawee, the drawee of an international sight draft owes the drawer no duty to pay an unadvised draft but if it does so and the draft is genuine, may appropriately debit the drawer's account. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:** To recognize and clarify, in law, certain established practices of international banking.

1. Checks drawn by one international bank on the account it carries (in a currency foreign to itself) in another international bank are still handled under practices which reflect older conditions, but which have a real, continuing reason in the typical, European rule that a bank paying a check in good faith and in ordinary course can charge its depositor's account notwithstanding forgery of a necessary indorsement. To decrease the risk that forgery will prove successful, the practice is to send a letter of advice that a draft has been drawn and will be forthcoming. Subsection (3) recognizes that a drawer who sends no such letter forfeits any rights for improper dishonor, while

still permitting the drawee to protect his delinquent drawer's credit.

2. Subsection (2) clears up for American courts, the meaning of another international practice: that of charging the drawer's account on receipt of the letter of advice. This practice involves no conception of trust or the like and the rule of Section 3—409(1) (Draft not an assignment) still applies. The debit has to do with the payment of interest only. The section recognizes the fact.

#### Cross reference:

Point 2: Section 3—409(1).

#### Definitional cross references:

"Account". Section 4—104.

"Bank". Section 1—201.

"Credit". Section 5—103.

"Draft". Section 3—104.

"Genuine". Section 1—201.

"Holder". Section 1—201.

### NORTH CAROLINA COMMENT

The Official Comment reasonably explains this rather esoteric instrument.

There are no known North Carolina cases on the matter.

## PART 8.

### MISCELLANEOUS.

§ 25-3-801. Drafts in a set.—(1) Where a draft is drawn in a set of parts, each of which is numbered and expressed to be an order only if no other part has been honored, the whole of the parts constitutes one draft but a taker of any part may become a holder in due course of the draft.

(2) Any person who negotiates, indorses or accepts a single part of a draft drawn in a set thereby becomes liable to any holder in due course of that part as if

it were the whole set, but as between different holders in due course to whom different parts have been negotiated the holder whose title first accrues has all rights to the draft and its proceeds.

(3) As against the drawee the first presented part of a draft drawn in a set is the part entitled to payment, or if a time draft to acceptance and payment. Acceptance of any subsequently presented part renders the drawee liable thereon under subsection (2). With respect both to a holder and to the drawer payment of a subsequently presented part of a draft payable at sight has the same effect as payment of a check notwithstanding an effective stop order (§ 25-4-407).

(4) Except as otherwise provided in this section, where any part of a draft in a set is discharged by payment or otherwise the whole draft is discharged. (1899, c. 733, ss. 178 to 183; Rev., ss. 2328 to 2333; C. S., ss. 3160 to 3165; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 178—183, Uniform Negotiable Instruments Law.

**Changes:** Combined and reworded.

##### Purposes of changes:

The revised language makes no important change in substance, and is intended only as a clarification and supplementation of the original sections:

1. Drafts in a set customarily contain such language as "Pay ——— this first of exchange (second unpaid)." with equivalent language in the second part. Today a part also commonly bears conspicuous indication of its number. At least the first factor is necessary to notify the holder of his rights, and is therefore necessary in order to make this section apply. Subsection (1) so provides, thus stating in the statute a matter left previously to a commercial practice long uniform but expensive to establish in court.

2. The final sentence of subsection (3) is new. Payment of the part of the draft subsequently presented is improper and

the drawee may not charge it to the account of the drawer, but someone has probably been unjustly enriched on the total transaction, at the expense of the drawee. So the drawee is like a bank which has paid a check over an effective stop payment order, and is subrogated as provided in that situation. Section 4—407.

3. A statement in a draft drawn in a set of parts to the effect that the order is effective only if no other part has been honored does not render the draft non-negotiable as conditional. See Section 3—112(1) (g).

##### Cross references:

Point 2: Section 4—407.

Point 3: Section 3—112.

##### Definitional cross references:

"Acceptance". Section 3—410.

"Check". Section 3—104.

"Draft". Section 3—104.

"Holder". Section 1—201.

"Holder in due course". Section 3—302.

"Honor". Section 1—201.

"Person". Section 1—201.

"Rights". Section 1—201.

#### NORTH CAROLINA COMMENT

This section simply combines and rewords several sections of NIL. Basically, the section adopts the rules of the NIL; however, there is one bit of new matter. The last sentence of subsection (3) states a new rule for rights and liabilities of

parties when the drawee pays both parts of the draft. See Official Comment 2.

(The whole area covered is of relatively minor importance because drafts in a set are not widely used in domestic commerce.)

#### § 25-3-802. Effect of instrument on obligation for which it is given.

—(1) Unless otherwise agreed where an instrument is taken for an underlying obligation

(a) the obligation is pro tanto discharged if a bank is drawer, maker or acceptor of the instrument and there is no recourse on the instrument against the underlying obligor; and

(b) in any other case the obligation is suspended pro tanto until the instrument is due or if it is payable on demand until its presentment. If the instrument is dishonored action may be maintained on either the instrument or the obligation; discharge of the underlying obligor on the instrument also discharges him on the obligation.



(2) The taking in good faith of a check which is not postdated does not of itself so extend the time on the original obligation as to discharge a surety. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. The section is new. It is intended to settle conflicts as to the effect of an instrument as payment of the obligation for which it is given.

2. Where a holder procures certification of a check the drawer is discharged under Section 3—411 on check certification. Thereafter the original obligation is regarded as paid, and the holder must look to the certifying bank. The circumstances may indicate a similar intent in other transactions, and the question may be one of fact for the jury. Subsection (1) (a) states a rule discharging the obligation pro tanto when the instrument taken carries the obligation of a bank as drawer, maker or acceptor and there is no recourse on the instrument against the underlying obligor.

3. It is commonly said that a check or other negotiable instrument is "conditional payment." By this it is normally meant that taking the instrument is a surrender of the right to sue on the obligation until the instrument is due, but if the instrument is not paid on due presentment the right to sue on the obligation is "revived." Subsection (1) (b) states this result in terms of suspension

of the obligation, which is intended to include suspension of the running of the statute of limitations. On dishonor of the instrument the holder is given his option to sue either on the instrument or on the underlying obligation. If, however, the original obligor has been discharged on the instrument (see Section 3—601) he is also discharged on the original obligation.

4. Subsection (2) is intended to remove any implication that a check given in payment of an obligation discharges a surety. The check is taken as a means of immediate payment; the thirty day period for presentment specified in Section 3—503 does not affect the surety's liability.

**Cross references:**

Point 2: Sections 1—201, 3—411 and 3—601.

Point 4: Section 3—503.

**Definitional cross references:**

"Action". Section 1—201.

"Bank". Section 1—201.

"Check". Section 3—104.

"Dishonor". Section 3—507.

"Good faith". Section 1—201.

"Instrument". Section 3—102.

"On demand". Section 3—108.

"Presentment". Section 3—504.

#### NORTH CAROLINA COMMENT

As explained in the Official Comment, this new section is designed to express several rules concerning the effect of a negotiable instrument on the underlying obligation for which it is given. This is an important section, and it possibly changes the prior North Carolina case law.

*Subsections 1 (a) and 1 (b):* These two subsections distinguish situations where (a) the underlying obligor is completely or pro tanto discharged from any further liability on the underlying obligation and (b) where the obligation is merely suspended pro tanto.

*Subsection 1 (a):* Under 1 (a) two conditions must exist before the obligor is discharged from the underlying obligation: (1) A bank must be liable on the instrument and (2) the obligor must not be liable on the instrument. A typical example is the cashier's check where a bank is liable and the obligor is not liable.

Where an obligee accepts a cashier's check procured by the obligor, the obligor is discharged from the underlying

obligation "unless otherwise agreed." If the instrument is not paid by the issuing bank due to insolvency, then the risk of such loss will fall on the obligee who took the check, rather than on the obligor who procured it.

In actual practice such situation probably will never be presented, because of deposit insurance and because of the fact that the courts can probably easily find that it was "otherwise agreed" (even in a case of absolute silence on the matter) that the obligor was to remain liable on the underlying contract until an actual payment of the cashier's check.

Such a finding would for practical purposes permit a continuation of prior North Carolina decisions that made a discharge of the underlying debt dependent on the intent of the parties: (1) *Andrews-Cooper Lumber Co. v. Hayworth*, 205 N.C. 585, 172 S.E. 194 (1934), held, there was no agreement that the cashier's check was to be in payment; (2) *South v. Sisk*, 205 N.C. 653, 172 S.E. 193 (1934), held, that there

was such agreement, and therefore the obligor was discharged on the underlying obligation even though the issuing bank did not pay the check because of insolvency.

*Subsection 1 (b):* This section adopts the view that in cases not covered by subsection 1 (a) the underlying obligation is merely suspended pro tanto pending a determination of whether the instrument given on the obligation will itself be paid or dishonored. North Carolina had adopted the "suspension" approach. *Costner v. Fisher*, 104 N.C. 392, 10 S.E. 526 (1889); *Bank of New Hanover v. Bridgers*, 98 N.C. 67, 3 S.E. 826 (1887).

Actually the new "suspension" section is somewhat ambiguous as it is not clear what remedies would be available to one holding an instrument that was "due" but which had not been "dishonored." The first sentence says that "the obligation is suspended until the instrument is due, or

if it is payable on demand until its presentment." The second sentence says that "If the instrument is dishonored, action may be maintained on either the instrument or the obligation." Thus, it is not entirely clear what rights a holder of a "due" though not "dishonored" instrument will have on the underlying contract. However, Official Comment 3 strongly implies (1) that the first sentence on "suspended" applies primarily to a suspension of the statute of limitations, and that (2) action on the underlying obligation is suspended until the instrument is "dishonored." Thus, in both theory and practice, the statute of limitations under the first sentence may begin to run again ("due" test) before the time that the holder may institute an action on the instrument or on the underlying contract ("dishonor" test). However, no modification is suggested on this item.

**§ 25-3-803. Notice to third party.**—Where a defendant is sued for breach of an obligation for which a third person is answerable over under this article he may give the third person written notice of the litigation, and the person notified may then give similar notice to any other person who is answerable over to him under this article. If the notice states that the person notified may come in and defend and that if the person notified does not do so he will in any action against him by the person giving the notice be bound by any determination of fact common to the two litigations, then unless after reasonable receipt of the notice the person notified does come in and defend he is so bound. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provisions:** None.

**Purposes:**

The section is new. It is intended to supplement, not to displace existing procedures for interpleader or joinder of parties.

The section conforms to the analogous provision in Section 2—607. It extends to such liabilities as those arising from forged indorsements even though not "on the instrument," and is intended to make it clear that the notification is not effective until received. In *Hartford Accident & Indemnity Co. v. First Nat. Bank & Trust Co.*, 281 N.Y. 162, 22 N.E.2d 324, 123 A.L.R. 1149 (1939), the common-law doctrine of "vouching in" was held inapplicable where the party notified had no direct liability to the party giving the notice. In that case the drawer of a check, sued by the payee whose indorsement had been forged, gave notice to a collect-

ing bank. In a second action the drawee was held liable to the drawer; but in an action by the drawee for judgment over against the collecting bank the determinations of fact in the first action were held not conclusive. This section does not disturb this result; the section is limited to cases where the person notified is "answerable over" to the person giving the notice.

**Cross reference:**

Section 2—607.

**Definitional cross references:**

"Action". Section 1—201.

"Defendant". Section 1—201.

"Instrument". Section 3—102.

"Notifies". Section 1—201.

"Person". Section 1—201.

"Right". Section 1—201.

"Seasonably". Section 1—204.

"Written". Section 1—201.

#### NORTH CAROLINA COMMENT

This section is a procedural one designed to permit parties defendant to give

notice of a pending action to any party who is answerable to the party defendant.

It does not actually permit a full scale "vouching in" of parties defendant. However, the limited "vouching in" does permit an application of "res judicata" on matters common to the pending action and a later action in a subsequent action by the first defendant against the person notified.

This procedure is intended to supplement and not replace existing procedures. See GS 1-73 (new parties by order of court), which permits a defendant to request a joinder of other parties.

**§ 25-3-804. Lost, destroyed or stolen instruments.**—The owner of an instrument which is lost, whether by destruction, theft or otherwise, may maintain an action in his own name and recover from any party liable thereon upon due proof of his ownership, the facts which prevent his production of the instrument and its terms. The court may require security indemnifying the defendant against loss by reason of further claims on the instrument. (1965, c. 700, s. 1.)

**Cross Reference.** — See note to § 25-3-505.

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

This section is new. It is intended to provide a method of recovery on instruments which are lost, destroyed or stolen. The plaintiff who claims to be the owner of such an instrument is not a holder as that term is defined in this Act, since he is not in possession of the paper, and he does not have the holder's prima facie right to recover under the section on the burden of establishing signatures. He must prove his case. He must establish the terms of the instrument and his ownership, and must account for its absence.

If the claimant testifies falsely, or if the instrument subsequently turns up in the hands of a holder in due course, the obligor may be subjected to double lia-

bility. The court is therefore authorized to require security indemnifying the obligor against loss by reason of such possibilities. There may be cases in which so much time has elapsed, or there is so little possible doubt as to the destruction of the instrument and its ownership that there is no good reason to require the security. The requirement is therefore not an absolute one, and the matter is left to the discretion of the court.

**Cross references:**

Sections 1—201 and 3—307.

**Definitional cross references:**

"Action". Section 1—201.

"Defendant". Section 1—201.

"Instrument". Section 3—102.

"Party". Section 1—201.

"Term". Section 1—201.

#### NORTH CAROLINA COMMENT

This section apparently makes no change in North Carolina law. While North Carolina had no statute dealing specifically with suit on a lost, destroyed, or stolen instrument, prior case law recognized that suit may be brought on such instruments and that the obligor is entitled to indemnity protection. See old cases collected in North Carolina Digest, Lost Instruments, Key Numbers 13-18, 24.

One of the most recent North Carolina cases on lost instruments is *Wooten v. Bell*, 196 N.C. 654, 146 S.E. 705 (1929), which held (1) that action may be brought on a lost note; (2) that defendant is at times entitled to indemnity; and (3) that recovery cannot be had on a note on which taxes are due.

This new section is similar to GS 98-19 (replacement of stolen, lost or destroyed State or municipal bonds; indemnity bond), which provides that the issuer of

governmental bonds is entitled to an indemnity in double the amount of any bonds to be issued to replace lost, stolen, or destroyed bonds.

The requirement of double indemnity is compulsory under GS 98-19; whereas GS 25-3-804 permits the judge to determine whether and in what amount any indemnity should be. Permitting the judge to have discretion on the matter of indemnity seems preferable, because in many cases the obligor will not need any indemnity to be fully protected. New York, however, has amended the UCC to make a double indemnity compulsory as is done in GS 98-19 for governmental bonds. Such amendment appears to be unwarranted. Prior North Carolina cases have made indemnity discretionary except where special statute made it mandatory as in GS 98-19.

Other North Carolina statutes relating to lost instruments are:



55-91—Lost or destroyed certificate of stock (now repealed).

25-167 (NIL, 160)—Protest where bill is lost (now repealed).

53-58—Photostatic copies of lost items; presentation of original by innocent holder.

Apparently neither the UCC nor any other existing North Carolina statute or case law govern the rights of an owner

or holder to demand a new negotiable instrument in place of a lost, destroyed or stolen one.

*Cross reference:* GS 25-3-301 permits any holder, whether or not he also be an owner, to sue in his own name, but GS 25-3-804 permits only an owner to enforce a lost, destroyed, or stolen instrument.

**§ 25-3-805. Instruments not payable to order or to bearer.**—This article applies to any instrument whose terms do not preclude transfer and which is otherwise negotiable within this article but which is not payable to order or to bearer, except that there can be no holder in due course of such an instrument. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

##### **Purposes:**

This section covers the “non-negotiable instrument.” As it has been used by most courts, this term has been a technical one of art. It does not refer to a writing, such as a note containing an express condition, which is not negotiable and is entirely outside of the scope of this Article and to be treated as a simple contract. It refers to a particular type of instrument which meets all requirements as to form of a negotiable instrument except that it is not payable to order or to bearer. The typical example is the check reading merely “Pay John Doe.”

Such a check is not a negotiable instrument under this Article. At the same time it is still a check, a mercantile specialty which differs in many respects from a simple contract. Commercial and banking practice treats it as a check, and a long line of decisions before and after the original Act have made it clear that it is subject to the law merchant as distinguished from ordinary contract law. Although the Negotiable Instruments Law has been held by its terms not to apply to such “non-negotiable instruments” it has been recognized as a codification and restatement of the law merchant, and has in fact been applied to them by analogy.

Thus the holder of the check reading “Pay A” establishes his case by production of the instrument and proof of signatures; and the burden of proving want

of consideration or any other defense is upon the obligor. Such a check passes by indorsement and delivery without words of assignment, and the indorser undertakes greater liabilities than those of an assignor. This section resolves a conflict in the decisions as to the extent of that undertaking by providing in effect that the indorser of such an instrument is not distinguished from any indorser of a negotiable instrument. The indorser is entitled to presentment, notice of dishonor and protest, and the procedure and liabilities in bank collection are the same. The rules as to alteration, the filling of blanks, accommodation parties, the liability of signing agents, discharge, and the like are those applied to negotiable instruments.

In short, the “non-negotiable instrument” is treated as a negotiable instrument, so far as its form permits. Since it lacks words of negotiability there can be no holder in due course of such an instrument, and any provision of any section of this Article peculiar to a holder in due course cannot apply to it. With this exception, such instruments are covered by all sections of this Article.

##### **Cross reference:**

Section 3—104.

##### **Definitional cross references:**

“Bearer”. Section 1—201.

“Holder in due course”. Section 3—302.

“Instrument”. Section 3—102.

“Term”. Section 1—201.

#### NORTH CAROLINA COMMENT

As stated in the Official Comment this new section is designed to permit money instruments that merely lack the words “order” or “bearer” to be treated as negotiable instruments subject to the provi-

sions of article 3; except that there can be no holder in due course of such instruments. Some “checks” omitting the word “order” are used in North Carolina today.

## ARTICLE 4.

*Bank Deposits and Collections.*

## PART 1.

## GENERAL PROVISIONS AND DEFINITIONS.

§ 25-4-101. **Short title.**—This article shall be known and may be cited as Uniform Commercial Code—Bank Deposits and Collections. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

The tremendous number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. Individual Federal Reserve banks process as many as 1,000,000 items a day; large metropolitan banks average 300,000 a day; banks with less than \$5,000,000 on deposit handle from 1,000 to 2,000 daily. There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years.

The American Bankers Association Bank Collection Code, enacted in eighteen states, has stated many of the bank collection rules that have developed and more recently Deferred Posting statutes

have developed and varied further rules. With items flowing in great volume not only in and around metropolitan and smaller centers but also continuously across state lines and back and forth across the entire country, a proper situation exists for uniform rules that will state in modern concepts at least some of the rights of the parties and in addition aid this flow and not interfere with its progress.

This Article adopts many of the rules of the American Bankers Association Code that are still in current operation, the principles and rules of the Deferred Posting and other statutes, codifies some rules established by court decisions and in addition states certain patterns and procedures that exist even though not heretofore covered by statute.

§ 25-4-102. **Applicability.**—(1) To the extent that items within this article are also within the scope of articles 3 and 8, they are subject to the provisions of those articles. In the event of conflict the provisions of this article govern those of article 3 but the provisions of article 8 govern those of this article.

(2) The liability of a bank for action or non-action with respect to any item handled by it for purposes of presentment, payment or collection is governed by the law of the place where the bank is located. In the case of action or non-action by or at a branch or separate office of a bank, its liability is governed by the law of the place where the branch or separate office is located. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. The rules governing negotiable instruments, their transfer, and the contracts of the parties thereto apply to the items collected through banking channels wherever no specific provision is found in this Article. In the case of conflict, this Article governs. See Section 3—103(2).

Bonds and like instruments constituting investment securities under Article 8 may also be handled by banks for collection purposes. Various sections of Article 8 prescribe rules of transfer some of which (see Sections 8—304 and 8—306) may conflict with provisions of this Article

(Sections 4—205 and 4—207). In the case of conflict, Article 8 governs.

Section 4—208 deals specifically with overlapping problems and possible conflicts between this Article and Article 9. However, similar reconciling provisions are not necessary in the case of Articles 5 and 7. Sections 4—301 and 4—302 are consistent with Section 5—112. In the case of Article 7 documents of title frequently accompany items but they are not themselves items. See Section 4—104(g).

2. Subsection (2) is designed to state a workable rule for the solution of otherwise vexatious problems of the conflicts of laws:

a. The routine and mechanical nature of bank collections makes it imperative that one law govern the activities of one office of a bank. The requirement found in some cases that to hold an indorser notice must be given in accordance with the law of the place of indorsement, since that method of notice became an implied term of the indorser's contract, is more theoretical than practical.

b. Adoption of what is in essence a tort theory of the conflict of laws is consistent with the general theory of this Article that the basic duty of a collecting bank is one of good faith and the exercise of ordinary care. Justification lies in the fact that, in using an ambulatory instrument, the drawer, payee, and indorsers must know that action will be taken with respect to it in other jurisdictions. This is especially pertinent with respect to the law of the place of payment.

c. The phrase "action or non-action with respect to any item handled by it for purposes of presentment, payment or collection" is intended to make the conflicts rule of subsection (2) apply from the inception of the collection process of an item through all phases of deposit, forwarding, presentment, payment and remittance or credit of proceeds. Specifically the subsection applies to the initial act of a depository bank in receiving an item and to the incidents of such receipt. The conflicts rule of *Weissman v. Banque de Bruxelles*, 254 N.Y. 488, 173 N.E.

835 (1930), is rejected. The subsection applies to questions of possible vicarious liability of a bank for action or non-action of sub-agents (see Section 4-202(3)) and tests these questions by the law of the state of the location of the bank which uses the sub-agent. The conflicts rule of *St. Nicholas Bank of New York v. State Nat. Bank*, 128 N.Y. 26, 27 N.E. 849, 13 L.R.A. 241 (1891), is rejected. The subsection applies to action or non-action of a payor bank in connection with handling an item (see Sections 4-213(1), 4-301, 4-302, 4-303) as well as action or non-action of a collecting bank (Sections 4-201 through 4-214); to action or non-action of a bank which suspends payment or is affected by another bank suspending payment (Section 4-214); to action or non-action of a bank with respect to an item under the rules of Part 4 of Article 4.

d. Where subsection (2) makes this Article applicable, Section 4-103(1) leaves open the possibility of an agreement with respect to applicable law. Such freedom of agreement follows the general policy of Section 1-105.

#### Cross references:

Sections 1-105; 3-103(2) and Article 3; all sections of Article 4; 5-112; Article 7; 8-304 and 8-306; Article 9.

#### Definitional cross references:

"Bank". Section 1-201.

"Branch". Section 1-201.

"Item". Section 4-104.

### NORTH CAROLINA COMMENT

*Subsection (1):* This recognizes that some items may be controlled in part by articles 3, 4, and 8. In the event of any conflict article 4 governs article 3; but article 8 governs article 4.

Because negotiable instruments constitute the bulk of bank collections, there will be much overlap between articles 3 and 4. However, this article is not limited to the collection of "negotiable instruments."

*Subsection (2):* This states a conflict of laws rule that the liability of a bank will be determined by the law of its situs. Thus, a bank need operate under only one law.

See GS 25-4-103 for variation by agreement.

See GS 25-4-104 which states: "'Item' means any instrument for the payment of money even though it is not negotiable but does not include money."

Because article 4 is not limited to negotiable instruments, it greatly expands the area of banking transactions that will be covered by more easily ascertainable rules. In the past nearly all statutes in North Carolina governing the collection process have applied only to negotiable instruments.

**§ 25-4-103. Variation by agreement; measure of damages; certain action constituting ordinary care.**—(1) The effect of the provisions of this article may be varied by agreement except that no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure; but the parties may by agreement determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.



(2) Federal reserve regulations and operating letters, clearing house rules, and the like, have the effect of agreements under subsection (1), whether or not specifically assented to by all parties interested in items handled.

(3) Action or non-action approved by this article or pursuant to federal reserve regulations or operating letters constitutes the exercise of ordinary care and, in the absence of special instructions, action or non-action consistent with clearing house rules and the like or with a general banking usage not disapproved by this article, *prima facie* constitutes the exercise of ordinary care.

(4) The specification or approval of certain procedures by this article does not constitute disapproval of other procedures which may be reasonable under the circumstances.

(5) The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount which could not have been realized by the use of ordinary care, and where there is bad faith it includes other damages, if any, suffered by the party as a proximate consequence. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see Sections 5 and 6 of the American Bankers Association Bank Collection Code.

##### Purposes:

1. Section 1—102 states the general principles and rules for variation of the effect of this Act by agreement and the limitations to this power. Section 4—103 states the specific rules for variation of Article 4 by agreement and also certain standards of ordinary care. In view of the technical complexity of the field of bank collections, the enormous number of items handled by banks, the certainty that there will be variations from the normal in each day's work in each bank, the certainty of changing conditions and the possibility of developing improved methods of collection to speed the process, it would be unwise to freeze present methods of operation by mandatory statutory rules. This section, therefore, permits within wide limits variation of provisions of the Article by agreement.

2. Subsection (1) confers blanket power to vary all provisions of the Article by agreements of the ordinary kind. The agreements may not disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care and may not limit the measure of damages for such lack or failure, but this subsection like Section 1—102(3) approves the practice of parties determining by agreement the standards by which such responsibility is to be measured. In the absence of a showing that the standards manifestly are unreasonable, the agreement controls. Owners of items and other interested parties are not affected by agreements under this subsection unless they are parties to the agreement or are

bound by adoption, ratification, estoppel or the like.

As here used "agreement" has the meaning given to it by Section 1—201(3). The agreement may be direct, as between the owner and the depository bank; or indirect, as where the owner authorizes a particular type of procedure and any bank in the collection chain acts pursuant to such authorization. It may be with respect to a single item; or to all items handled for a particular customer, e. g., a general agreement between the depository bank and the customer at the time a deposit account is opened. Legends on deposit tickets, collection letters and acknowledgments of items, coupled with action by the affected party constituting acceptance, adoption, ratification, estoppel or the like, are agreements if they meet the tests of the definition of "agreement". See Section 1—201(3). *First Nat. Bank of Denver v. Federal Reserve Bank*, 6 F.2d 339 (8th Cir. 1925) (deposit slip); *Jefferson County Bldg. Ass'n v. Southern Bank & Trust Co.*, 225 Ala. 25, 142 So. 66 (1932) (signature card and deposit slip); *Semington v. Stock Yards Nat. Bank*, 162 Minn. 424, 203 N.W. 412 (1925) (passbook); *Farmers State Bank v. Union Nat. Bank*, 42 N.D. 449, 454, 173 N.W. 789, 790 (1919) (acknowledgment of receipt of item).

3. Subsection (1) (subject to its limitations with respect to good faith and ordinary care) goes far to meet the requirements of flexibility. However, it does not by itself confer fully effective flexibility. When it is recognized that banks handle probably 25,000,000 items every business day and that the parties interested in each item include the owner of the item, the drawer (if it is a check), all non-bank indorsers, the payor bank

and from one to five or more collecting banks, it is obvious that it is impossible, practically, to obtain direct agreements from all of these parties on all items. *En masse*, the interested parties constitute virtually every adult person and business organization in the United States. On the other hand they may become bound to agreements on the principle that collecting banks acting as agents have authority to make binding agreements with respect to items being handled. This conclusion was assumed but was not flatly decided in *Federal Reserve Bank of Richmond v. Malloy*, 264 U.S. 160, at 167, 44 S.Ct. 296, at 298, 68 L. Ed. 617, 31 A.L.R. 1261 (1924).

To meet this problem subsection (2) provides that official or quasi-official rules of collection, that is Federal Reserve regulations and operating letters, clearing-house rules, and the like, have the effect of agreements under subsection (1), whether or not specifically assented to by all parties interested in items handled. Consequently, such official or quasi-official rules may, standing by themselves but subject to the good faith and ordinary care limitations, vary the effect of the provisions of Article 4.

*Federal Reserve regulations.* Various sections of the Federal Reserve Act (12 U.S.C.A. § 221 et seq.) authorize the Board of Governors of the Federal Reserve System to direct the Federal Reserve banks to exercise bank collection functions. For example, Section 16 (12 U.S.C.A. § 248(o)) authorizes the Board to require each Federal Reserve bank to exercise the functions of a clearing-house for its members and Section 13 (12 U.S.C.A. § 342) authorizes each Federal Reserve bank to receive deposits from non-member banks solely for the purposes of exchange or of collection. Under this statutory authorization the Board has issued Regulation J (Check Clearing and Collection), which has been infrequently amended over the many years during which it has been in force. (Regulation G, issued under comparable statutory authority, covers the handling of "non-cash items"). Where regulations issued by the Board in pursuance of its statutory mandate may be said to have some force of law and constitute an effective means of maintaining flexibility, it is appropriate to provide that such regulations may vary this Article even though not specifically assented to by all parties interested in items handled.

*Federal Reserve operating letters.* The regulations of the Federal Reserve Board

authorize the Federal Reserve banks to promulgate rules covering operating details. Regulation J, for example, provides that each bank may promulgate rules "not inconsistent with the terms of the law or of this regulation governing the sorting, listing, packaging and transmission of items and other details of its check clearing and collection operation. Such rules . . . shall be set forth . . . in . . . letters of instructions to . . . member and non-member clearing banks." The term "operating letters" means these "letters of instructions", sometimes called "operating circulars", issued by the Federal Reserve banks under appropriate regulation of the Board. This Article recognizes such "operating letters" issued pursuant to the regulations and concerned with operating details as appropriate means, within their proper sphere, to vary the effect of the Article.

*Clearing House Rules.* Local clearing houses have long issued rules governing the details of clearing; hours of clearing, media of remittance, time for return of mis-sent items and the like. The case law has recognized such rules, within their proper sphere, as binding on affected parties and as appropriate sources for the courts to look to in filling out details of bank collection law. Subsection (2) in recognizing clearing house rules as a means of preserving flexibility continues the sensible approach indicated in the cases. Included in the term "clearing houses" are county and regional clearing houses as well as those within a single city or town. There is, of course, no intention of authorizing a local clearing house or a group of clearing houses to rewrite the basic law generally. The term "clearing house rules" should be understood in the light of functions the clearing houses have exercised in the past.

*And the like.* This phrase is to be construed in the light of the foregoing. "Federal Reserve regulations and operating letters" cover rules and regulations issued by public or quasi-public agencies under statutory authority. "Clearing house rules" cover rules issued by a group of banks which have associated themselves to perform through a clearing house some of their collection, payment and clearing functions. Other such agencies or associations may be established in the future whose rules and regulations could be appropriately looked on as constituting means of avoiding absolute statutory rigidity. The phrase "and the like" leaves open such possibilities of future development. An agreement between a number

of banks or even all the banks in an area simply because they are banks, would not of itself, by virtue of the phrase "and the like," meet the purposes and objectives of subsection (2).

4. Under this Article banks come under the general obligations of the use of good faith and the exercise of ordinary care. "Good faith" is defined in this Act (Section 1—201(19)) as "honesty in fact in the conduct or transaction concerned." The term "ordinary care" is not defined and is here used with its normal tort meaning and not in any special sense relating to bank collections. No attempt is made in the Article to define *in toto* what constitutes ordinary care or lack of it. Section 4—202 states respects in which collecting banks must use ordinary care. Subsection (3) of 4—103 provides that action or non-action approved by the Article or pursuant to Federal Reserve regulations or operating letters constitutes the exercise of ordinary care. Where Federal Reserve regulations and operating letters are issued pursuant to statutory mandate as indicated above, they constitute an affirmative standard of ordinary care equal with the provisions of Article 4 itself.

Subsection (3) further provides that, absent special instructions, action or non-action consistent with clearing house rules and the like or with a general banking usage not disapproved by the Article, *prima facie* constitutes the exercise of ordinary care. Clearing house rules and the phrase "and the like" have the significance set forth above in these Comments. The term "general banking usage" is not defined but should be taken to mean a general usage common to banks in the area concerned. See Section 1—205(2). Where the adjective "general" is used the intention is to require a usage broader than a mere practice between two or three banks but it is not intended to require anything as broad as a country-wide usage. A usage followed generally throughout a state, a substantial portion of a state, a metropolitan area or the like would certainly be sufficient. Consistent with the principle of Section 1—205(3), action or non-action consistent with clearing house rules or the like or with such banking usages *prima facie* constitutes the exercise of ordinary care. However, the phrase "in the absence of special instructions" affords owners of items an opportunity to prescribe other standards and where there may be no direct supervision or control of clearing houses or banking usages by official super-

visory authorities, the confirmation of ordinary care by compliance with these standards is *prima facie* only, thus conferring on the courts the ultimate power to determine ordinary care in any case where it should appear desirable to do so. The *prima facie* rule does, however, impose on the party contesting the standards to establish that they are unreasonable, arbitrary or unfair.

5. Subsection (4), in line with the flexible approach required for the bank collection process is designed to make clear that a novel procedure adopted by a bank is not to be considered unreasonable merely because that procedure is not specifically contemplated by this Article or by agreement, or because it has not yet been generally accepted as a bank usage. Changing conditions constantly call for new procedures and someone has to use the new procedure first. If such a procedure when called in question is found to be reasonable under the circumstances, provided, of course, that it is not inconsistent with any provision of the Article or other law or agreement, the bank which has followed the new procedure should not be found to have failed in the exercise of ordinary care.

6. Subsection (5) sets forth a rule for determining the measure of damages which, under subsection (1), cannot be limited by agreement. In the absence of bad faith the maximum recovery is the amount of the item concerned. When it is established that some part or all of the item could not have been collected even by the use of ordinary care the recovery is reduced by the amount which would have been in any event uncollectible. This limitation on recovery follows the case law. Finally, when bad faith is established the rule opens to allow the recovery of other damages, whose "proximateness" is to be tested by the ordinary rules applied in comparable cases. Of course, it continues to be as necessary under subsection (5) as it has been under ordinary common law principles that, before the damage rule of the subsection becomes operative, liability of the bank and some loss to the customer or owner must be established.

#### Cross references:

Sections 1—102(3), 1—203, 1—205 and 4—202.

#### Definitional cross references:

"Bank". Section 1—201.

"Good faith". Section 1—201.

"Item". Section 4—104.

"Usage". Section 1—205.



NORTH CAROLINA COMMENT

A bank may not disclaim its responsibility for its own lack of good faith or failure to exercise ordinary care; but generally other express or implied agreements will be recognized.

Flexibility is permitted by subsection (4) which recognizes that procedures not spe-

cifically approved by article 4 may nevertheless be reasonable.

Subsection (5) states the usual rule on the measure of damages for (1) mere negligence and (2) for bad faith action or inaction.

§ 25-4-104. **Definitions and index of definitions.**—(1) In this article unless the context otherwise requires

(a) "Account" means any account with a bank and includes a checking, time, interest or savings account;

(b) "Afternoon" means the period of a day between noon and midnight;

(c) "Banking day" means that part of any day on which a bank is open to the public for carrying on substantially all of its banking functions;

(d) "Clearing house" means any association of banks or other payors regularly clearing items;

(e) "Customer" means any person having an account with a bank or for whom a bank has agreed to collect items and includes a bank carrying an account with another bank;

(f) "Documentary draft" means any negotiable or nonnegotiable draft with accompanying documents, securities or other papers to be delivered against honor of the draft;

(g) "Item" means any instrument for the payment of money even though it is not negotiable but does not include money;

(h) "Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later;

(i) "Properly payable" includes the availability of funds for payment at the time of decision to pay or dishonor;

(j) "Settle" means to pay in cash, by clearing house settlement, in a charge or credit or by remittance, or otherwise as instructed. A settlement may be either provisional or final;

(k) "Suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over or that it ceases or refuses to make payments in the ordinary course of business.

(2) Other definitions applying to this article and the sections in which they appear are:

"Collecting bank"	§ 25-4-105.
"Depository bank"	§ 25-4-105.
"Intermediary bank"	§ 25-4-105.
"Payor bank"	§ 25-4-105.
"Presenting bank"	§ 25-4-105.
"Remitting bank"	§ 25-4-105.

(3) The following definitions in other articles apply to this article:

"Acceptance"	§ 25-3-410.
"Certificate of deposit"	§ 25-3-104.
"Certification"	§ 25-3-411.
"Check"	§ 25-3-104.
"Draft"	§ 25-3-104.
"Holder in due course"	§ 25-3-302.
"Notice of dishonor"	§ 25-3-508.
"Presentment"	§ 25-3-504.
"Protest"	§ 25-3-509.
"Secondary party"	§ 25-3-102.

(4) In addition article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. Subsection (1) (c): "Banking day". Under this definition that part of a business day when a bank is open only for limited functions, e. g., on Saturday evenings to receive deposits and cash checks, but with loan, bookkeeping and other departments closed, is not part of a banking day.

2. Subsection (1) (d): "Clearing house". Occasionally express companies, governmental agencies and other non-banks deal directly with a clearing house; hence the definition does not limit the term to an association of banks.

3. Subsection (1) (e): "Customer". It is to be noted that this term includes a bank carrying an account with another bank as well as the more typical non-bank customer or depositor.

4. Subsection (1) (g): The word "item" is chosen because it is "banking language" and includes non-negotiable as well as negotiable paper calling for money and also similar paper governed by the Article on Investment Securities (Article 8) as well as that governed by the Article on Commercial Paper (Article 3).

5. Subsection (1) (h): "Midnight deadline". The use of this phrase is an example of the more mechanical approach used in this Article. Midnight is selected as a termination point or time limit to obtain greater uniformity and definiteness than would be possible from other possible termination points, such as the close of the banking day or business day.

6. Subsection (1) (j): The term "settle" is a new term in bank collection language that has substantial importance throughout Article 4. In the American Bankers Association Bank Collection Code, in deferred posting statutes, in Federal Reserve regulations and operating letters, in clearing house rules, in agreements between banks and customers and in legends on deposit tickets and collection letters, there is repeated reference to "conditional" or "provisional" credits or payments. Tied in with this concept of credits or payments being in some way tentative, has been a related but somewhat different problem as to when an item is "paid" or "finally paid" either to determine the relative priority of the item as against attachments, stop payment orders and the like or in insolvency situations. There has been extensive litigation in the

various states on these problems. To a substantial extent the confusion, the litigation and even the resulting court decisions fail to take into account that in the collection process some debits or credits are provisional or tentative and others are final and that very many debits or credits are provisional or tentative for awhile but later become final. Similarly, some cases fail to recognize that within a single bank, particularly a payor bank, each item goes through a series of processes and that in a payor bank most of these processes are preliminary to the basic act of payment or "final payment".

The term "settle" is used as a convenient term to characterize a broad variety of conditional, provisional, tentative and also final payments of items. Such a comprehensive term is needed because it is frequently difficult or unnecessary to determine whether a particular action is tentative or final or when a particular credit shifts from the tentative class to the final class. Therefore, its use throughout the Article indicates that in that particular context it is unnecessary or unwise to determine whether the debit or the credit or the payment is tentative or final. However, when qualified by the adjective "provisional" its tentative nature is intended, and when qualified by the adjective "final" its permanent nature is intended.

Examples of the various types of settlement contemplated by the term include payments in cash; the efficient but somewhat complicated process of payment through the adjustment and offsetting of balances through clearing houses; debit or credit entries in accounts between banks; the forwarding of various types of remittance instruments, sometimes to cover a particular item but more frequently to cover an entire group of items received on a particular day.

7. Subsection (1) (k): "Suspends payments". This term is designed to afford an objective test to determine when a bank is no longer operating as a part of the banking system.

**Definitional cross references:**

"Bank". Section 1—201.

"Documents". Section 1—201.

"Money". Section 1—201.

"Negotiable". Section 3—104.

"Notice". Section 1—201.

"Person". Section 1—201.

"Securities". Section 8—102.

## NORTH CAROLINA COMMENT

The definitions given make no major changes in North Carolina law; however, a familiarity with the definitions is necessary to a reasonable comprehension of the UCC.

§ 25-4-105. "Depository bank"; "intermediary bank"; "collecting bank"; "payor bank"; "presenting bank"; "remitting bank."—In this article unless the context otherwise requires:

(a) "Depository bank" means the first bank to which an item is transferred for collection even though it is also the payor bank;

(b) "Payor bank" means a bank by which an item is payable as drawn or accepted;

(c) "Intermediary bank" means any bank to which an item is transferred in course of collection except the depository or payor bank;

(d) "Collecting bank" means any bank handling the item for collection except the payor bank;

(e) "Presenting bank" means any bank presenting an item except a payor bank;

(f) "Remitting bank" means any payor or intermediary bank remitting for an item. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. The definitions in general exclude a bank to which an item is issued, as such bank does not take by transfer except in the particular case covered where the item is issued to a payee for collection, as where a corporation is transferring balances from one account to another. Thus, the definition of "depository bank" does not include the bank to which a check is made payable where a check is given in payment of a mortgage. Such a bank has the status of a payee under Article 3 on Commercial Paper and not that of a collecting bank.

2. The term payor bank includes a drawee bank and also a bank at which an item is payable if the item constitutes an order on the bank to pay, for it is then "payable by" the bank. If the "at" item is not an order in the particular

state, (See Section 3—121) then the bank is not a payor, but will be a presenting or collecting bank.

3. Items are sometimes drawn or accepted "payable through" a particular bank. Under this Section and Section 3—120 the "payable through" bank (if it in fact handles the item) will be a collecting (and often a presenting) bank; it is not a "payor bank."

4. The term intermediary bank includes the last bank in the collection process where the payor is not a bank. Usually the last bank is also a presenting bank.

**Cross references:**

Article 3, especially Sections 3—120 and 3—121.

**Definitional cross references:**

"Bank". Section 1—201.

"Customer". Section 4—104.

"Item". Section 4—104.

## NORTH CAROLINA COMMENT

The definitions in general exclude a bank to which an item is issued.

The term "payor bank" includes a drawee bank. Whether "payor bank" includes a bank "at" which an instrument is merely payable will depend on which alternative is adopted under GS 25-3-121 (instruments payable at bank). Since Alternative B of GS 25-3-121 is adopted in North Carolina, a bank "at" which an instrument is payable will not be a "payor bank" because the instrument will not be an "order" on it. Such bank will be a

"presenting bank" or a "collecting bank." See Official Comment 2.

*Suggested possible amendment:* Further study and consultation with the Permanent Editorial Board may reveal that GS 25-3-120, 25-3-121, 25-4-105 (b), 25-4-204 (2) (a) and other sections of articles 3 and 4 should be amended to more clearly describe: (1) The exact nature of an instrument payable "through" or "at" a bank; and (2) the technical rights and duties of the bank in question.

§ 25-4-106. **Separate office of a bank.**—A branch or separate office of a bank maintaining its own deposit ledgers is a separate bank for the purpose of computing the time within which and determining the place at or to which action may



be taken or notices or orders shall be given under this article and under article 3. (1965, c. 700, s. 1.)

**Editor's Note.**—The optional language referred to in the last paragraph of the

Official Comment has been included in this section.

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see Section 1, American Bankers Association Bank Collection Code.

##### Purposes:

1. A rule with respect to the status of a branch or separate office of a bank as a part of any statute on bank collections is highly desirable if not absolutely necessary. However, practices in the operations of branches and separate offices vary substantially in the different states and it has not been possible to find any single rule that is logically correct, fair in all situations and workable under all different types of practices.

2. In many states and for many purposes a branch or separate office of the bank needs to be treated as a separate bank. Many branches function as separate banks in the handling and payment of items and require time for doing so similar to that of a separate bank. This is particularly true where branch banking is permitted throughout a state or in different towns and cities. Similarly, where there is this separate functioning a particular branch or separate office is the only proper place for various types of action to be taken or orders or notices to be given. Examples include the drawing of a check on a particular branch by a customer whose account is carried at that branch; the presentment of that same check at that branch; the issuance of an order to the branch to stop payment on the check.

3. Section 1 of the American Bankers Association Bank Collection Code provides simply: "A branch or office of any such bank shall be deemed a bank." Although this rule appears to be brief and simple, as applied to particular sections of the ABA Code it produces illogical and, in some cases, unreasonable results. For example, under Section 11 of the ABA Code it seems anomalous for one branch of a bank to have charged an item to the account of the drawer and another branch to have the power to elect to treat the item as dishonored. Similar logical problems would flow from applying the same rule to Article 4. Warranties by one branch to another branch under Section 4—207 (each considered a separate bank) do not make sense.

4. Assuming that it is not desirable to make each branch a separate bank for

all purposes, this Section provides that a branch or separate office is a separate bank for certain purposes. In so doing the single legal entity of the bank as a whole is preserved, thereby carrying with it the liability of the institution as a whole on such obligations as it may be under. On the other hand, where the Article provides a number of time limits for different types of action by banks, if a branch functions as a separate bank, it should have the time limits available to a separate bank. Similarly if in its relations to customers a branch functions as a separate bank, notices and orders with respect to accounts of customers of the branch should be given at the branch. For example, whether a branch has notice sufficient to affect its status as a holder in due course of an item taken by it should depend upon what notice that branch has received with respect to the item. Similarly the receipt of a stop payment order at one branch should not be notice to another branch so as to impair the right of the second branch to be a holder in due course of the item, although in circumstances in which ordinary care requires the communication of a notice or order to the proper branch of a bank, such notice or order would be effective at such proper branch from the time it was or should have been received. See Section 1—201(27).

5. Whether a branch functions as a separate bank may vary depending upon the type of activity taking place and upon practices in the different states. If the activity is that of a payor bank paying items, a branch will usually function as a separate bank if it maintains its own deposit ledgers. Similarly whether a branch functions as a separate bank in the collection of items usually depends also on whether it maintains its own deposit ledgers. Conversely, if a particular bank having branches does all of its bookkeeping at its head office, the branches of that bank do not usually function as separate banks either in the payment or collection of items.

On the other hand, in its relations to customers a branch may function as a separate bank regardless of whether it maintains its own deposit ledgers. Checks may be drawn on a particular branch and notices and stop orders delivered to

that branch even though all the bookkeeping is done at the head office or another branch.

Where the words "maintaining its own deposit ledgers" are bracketed, the option is given to each state enacting the Code to include these words as a test of separateness. In those states where the maintenance by a branch of its own deposit ledgers will serve as a satisfactory standard, the bracketed words should be retained. In those states where these words will cause more problems than benefits, they may be deleted. Insofar as this latter

rule allows extra time to banks maintaining branches where such extra time is not needed, it is not ideal. However, it has not been found possible to find a rule that will meet this problem and will work in all cases. Further, it is highly unlikely that large banks maintaining branches will needlessly take advantage of extra time under this rule.

**Cross references:**

Sections 3—504, 4—102(2).

**Definitional cross references:**

"Bank". Section 1—201.

"Branch". Section 1—201.

§ 25-4-107. **Time of receipt of items.**—(1) For the purpose of allowing time to process items, prove balances and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of 2:00 o'clock P.M. or later as a cut-off hour for the handling of money and items and the making of entries on its books.

(2) Any item or deposit of money received on any day after a cut-off hour so fixed or after the close of the banking day may be treated as being received at the opening of the next banking day. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.  
**Purposes:**

1. After an item has been received by a bank it goes through a series of processes varying with the type of item that it is. It moves from the teller's window, branch office, or mail desk at which it is received through settlement and proving departments until it is forwarded or presented to a clearing house or another bank, if it is a transit item, or until it reaches the bookkeeping department, if the bank receiving it is the payor bank. In addition, in order that the books of the bank always remain in balance while items are moving through it, the amount of each item is included in lists or proofs of debits or credits several times as it progresses through the bank. The running of proofs, the making of debit and credit entries in subsidiary and general ledgers and the striking of a general balance for each day requires a considerable amount of time. If these processes are to be completed on any particular day during normal working hours without the employment of night forces, a number of banks have found it necessary to establish a "cut-off hour" to allow time to obtain final figures to be incorporated into the bank's position for the day. Subsection (1) approves a cut-off hour of this type provided it is not earlier than

2 P. M. Subsection (2) provides that if such a cut-off hour is fixed, items received after the cut-off hour may be treated as being received at the opening of the next banking day. Where the number of items received either through the mail or over the counter tends to taper off radically as the afternoon hours progress, a 2 P. M. cut-off hour does not involve a large portion of the items received but at the same time permits a bank using such a cut-off hour to leave its doors open later in the afternoon without forcing into the evening the completion of its settling and proving process.

2. The alternative provision in Subsection (2) that items or deposits received after the close of the banking day may be treated as received at the opening of the next banking day is important in cases where a bank closes at twelve or one o'clock, e. g., on a Saturday, but continues to receive some items by mail or over the counter if, for example, it opens Saturday evening for the limited purpose of receiving deposits and cashing checks.

**Definitional cross references:**

"Afternoon". Section 4—104.

"Bank". Section 1—201.

"Banking day". Section 4—104.

"Item". Section 4—104.

"Money". Section 1—201.

**NORTH CAROLINA COMMENT**

This permits items received after the earlier of (a) the 2:00 P.M. "cut-off" or (b) the close of the banking day to be

treated as received at the opening of the next banking day. *Example:* Banks that remain open on Friday until 6:00 P.M.

and are closed on Saturday, may treat items received after 2:00 P.M. Friday as being received on the next Monday morning.

This provision is not mandatory on the banks.

**§ 25-4-108. Delays.**—(1) Unless otherwise instructed, a collecting bank in a good faith effort to secure payment may, in the case of specific items and with or without the approval of any person involved, waive, modify or extend time limits imposed or permitted by this chapter for a period not in excess of an additional banking day without discharge of secondary parties and without liability to its transferor or any prior party.

(2) Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by this chapter or by instructions is excused if caused by interruption of communication facilities, suspension of payments by another bank, war, emergency conditions or other circumstances beyond the control of the bank provided it exercises such diligence as the circumstances require. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. Sections 4—202(2), 4—212, 4—301 and 4—302 prescribe various time limits for the handling of items. These are the limits of time within which a bank, in fulfillment of its obligation to exercise ordinary care, must handle items entrusted to it for collection or payment. Under Section 4—103 they may be varied by agreement or by Federal Reserve regulations or operating letters, clearing house rules, or the like.

2. Subsection (1) of this section permits a limited extension of these time limits in special cases. It permits collecting banks to grant, within a rather narrow field, an additional banking day and to do so with or without the approval of any interested party. Such one-day extension can only be granted in a good faith effort to secure payment and only with respect to specific items. It cannot be exercised if the customer instructs otherwise. Thus limited the escape provision should afford a limited degree of flexibility in special cases but should not interfere with the overall requirement and objective of speedy collections.

3. Notice that an extension granted under Subsection (1) is "without discharge of secondary parties". It therefore extends also the times for presentment or payment, as the case may be, specified in Article 3. See Sections 3—503 and 3—506. Where this Article and Article 3 conflict, this Article controls. See Sections 3—103(2) and 4—102(1).

4. Subsection (2) is another escape clause from time limits. This clause operates not only with respect to time limits imposed by the Article itself but also time limits imposed by special instructions, by agreement or by Federal Reserve regulations or operating letters, clearing house rules or the like. The latter time limits are "permitted" by the Code. This clause operates, however, only in the types of situation specified. Examples of these situations include blizzards, floods, or hurricanes, and other "Act of God" events or conditions, and wrecks or disasters, interfering with mails; suspension of payments by another bank; abnormal operating conditions such as substantial increased volume or substantial shortage of personnel during war or emergency situations. When delay is sought to be excused under this subsection the bank must "exercise such diligence as the circumstances require" and it has the burden of proof. See Section 4—202(2).

**Cross references:**

Sections 3—103(2), 3—503, 3—506. 4—102(1), 4—103, 4—104, 4—202(2), 4—212, 4—213, 4—301, 4—302.

**Definitional cross references:**

"Bank". Section 1—201.

"Banking day". Section 4—104.

"Collecting bank". Section 4—105.

"Good faith". Section 1—201.

"Item". Section 4—104.

"Party". Section 1—201.

#### NORTH CAROLINA COMMENT

The section permits two delays to be harmless:

*Subsection (1):* This subsection gives an extra day for timely action in secur-

ing payment. The extra day is permitted only when bank acts in good faith. Thus, it cannot be exercised when a customer instructs otherwise.



Since time may be extended "without discharge of secondary parties," this section will extend the time for presentment or payment under GS 25-3-503 and 25-3-506, because article 4 controls article 3.

*Subsection (2):* This subsection permits even further delay to be harmless when certain emergencies cause the delay.

**§ 25-4-109. Process of posting.**—The "process of posting" means the usual procedure followed by a payor bank in determining to pay an item and in recording the payment including one or more of the following or other steps as determined by the bank:

- (a) verification of any signature;
- (b) ascertaining that sufficient funds are available;
- (c) affixing a "paid" or other stamp;
- (d) entering a charge or entry to a customer's account;
- (e) correcting or reversing an entry or erroneous action with respect to the item. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provisions:** None.

**Purposes:**

Completion of the "process of posting" is one of the measuring points for determining when an item is finally paid (subsection (1) (c) of Section 4—213) and when knowledge, notice, stop order, legal process and set-off come too late to affect a payor bank's right or duty to pay an item (subsection (1) (d) of Section 4—303). This Section defines what is meant by the "process of posting". It is the "usual procedure followed by a payor bank in determining to pay an item and in recording the payment . . .". It involves the two basic elements of some decision to pay and some recording of the payment with a listing of some of the typical steps that might be involved. Procedures followed by banks in determining to pay an item and in recording the payment vary. Examples of some of these procedures will illustrate what is meant by completion of the "process of posting".

Example 1. A payor bank receives an item through the clearing on Monday morning. It is sorted under the name of the customer on Monday and under deferred posting routines (Section 4—301) reaches the bookkeeper for that customer on Tuesday morning. The bookkeeper examines the signature, verifies there are sufficient funds and decides at 11 a. m. on Tuesday to pay the item. A debit entry for or including the amount of the item is entered in the customer's account at 12 noon on Tuesday. The process of posting is completed at 12 noon on Tuesday.

Example 2. A payor bank with branches receives an item through the clearing on

Monday morning. One branch does all the bookkeeping for itself and nine other branches. The item is sent to that branch and a provisional debit is entered to the customer's account for the amount of the item on Monday. After this entry is made the item is sent to the branch where the customer transacts business and at this branch a clerk verifies the signature on Tuesday, e. g. at 12 noon. If the clerk determines the signature is valid and makes a decision to pay, the process of posting is completed at 12 noon on Tuesday because there has been both a charge to the customer's account and a determination to pay. If, however, the clerk determines the signature is not valid or that the item should not be paid for some other reason, the item is then returned to the presenting bank through the clearing house and an offsetting credit entry is made in the customer's account by the bookkeeping branch. In this case there has been no determination to pay the item, no completion of the process of posting and no payment of the item.

Example 3. A payor bank receives in the mail on Monday an item drawn upon it. The item is sorted and otherwise processed on Monday and during Monday night is provisionally recorded on tape by an electronic computer as charged to the customer's account. On Tuesday a clerk examines the signature on the item and makes other checks to determine finally whether the item should be paid. If the clerk determines the signature is valid and makes a decision to pay and all processing of this item is complete, e. g., at 12 noon on Tuesday, the "process of posting" is completed at that time.

If, however, the clerk determines the signature is not valid or that the item should not be paid for some other reason, the item is returned to the presenting bank and in the regular Tuesday night run of the computer the debit to the customer's account for the item is reversed or an offsetting credit entry is made. In this case, as in Example 2, there has been no determination to pay

the item, no completion of the process of posting and no payment of the item.

**Cross references:**

Sections 4—213(1) (c), 4—303 (1) (d).

**Definitional cross references:**

"Account". Section 4—104(1) (a).

"Customer". Section 4—104 (1) (e).

"Item". Section 4—104(1) (g).

"Payor bank". Section 4—105 (b).

**NORTH CAROLINA COMMENT**

This section simply defines "process of posting" to mean a bank's "usual procedure" of performing routine bookkeeping functions.

Completion of the "process of posting" is one of the measuring points for determining: (a) "Final payment of item by payor bank" under GS 25-4-213 (1) (c) and (b) when knowledge, notice, stop order, legal process and setoff come too late to affect a payor bank's right or duty to pay an item under GS 25-4-303 (1) (d).

*Note:* A "usual procedure" test for determining a fixed time will naturally be productive of future litigation; and yet it seems impossible to legislate a more concrete test for certain cut-off times. Thus, a court must construe this section loosely to achieve substantive justice between the parties when this section and the other sections it affects are in issue.

**PART 2.**

**COLLECTION OF ITEMS: DEPOSITARY AND COLLECTING BANKS.**

**§ 25-4-201. Presumption and duration of agency status of collecting banks and provisional status of credits; applicability of article; item indorsed "pay any bank."**—(1) Unless a contrary intent clearly appears and prior to the time that a settlement given by a collecting bank for an item is or becomes final (subsection (3) of § 25-4-211 and §§ 25-4-212 and 25-4-213) the bank is an agent or subagent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank such as those resulting from outstanding advances on the item and valid rights of setoff. When an item is handled by banks for purposes of presentment, payment and collection, the relevant provisions of this article apply even though action of parties clearly establishes that a particular bank has purchased the item and is the owner of it.

(2) After an item has been indorsed with the words "pay any bank" or the like, only a bank may acquire the rights of a holder

(a) until the item has been returned to the customer initiating collection; or

(b) until the item has been specially indorsed by a bank to a person who is not a bank. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None; but see Sections 2 and 4 of the American Bankers Association Bank Collection Code.

**Purposes:**

1. This section states certain basic rules and presumptions of the bank collection process. One basic rule, appearing in the last sentence of subsection (1) is that, to the extent applicable, the provi-

sions of the Article govern without regard to whether a bank handling an item owns the item or is an agent for collection. Historically, much time has been spent and effort expended in determining or attempting to determine whether a bank was a purchaser of an item or merely an agent for collection. See discussion of this subject and cases cited in 11 A.L.R. 1043, 16 A.L.R. 1084, 42

A.L.R. 492, 68 A.L.R. 725, 99 A.L.R. 486. See also Section 4 of the American Bankers Association Bank Collection Code. The general approach of Article 4, similar to that of other Articles, is to provide, within reasonable limits, rules or answers to major problems known to exist in the bank collection process without regard to questions of status and ownership but to keep general principles such as status and ownership available to cover residual areas not covered by specific rules. In line with this approach, the last sentence of subsection (1) says in effect that Article 4 applies to practically every item moving through banks for the purpose of presentment, payment or collection.

2. Within this general rule of broad coverage, the first two sentences of subsection (1) state a rule of status in terms of a strong presumption. "Unless a contrary intent clearly appears" the status of a collecting bank is that of an agent or sub-agent for the owner of the item. Although as indicated in Comment 1 it is much less important under Article 4 to determine status than has been the case heretofore, such status may have importance in some residual areas not covered by specific rules. Further, where status has been considered so important in the past, to omit all reference to it might cause confusion. The presumption of agency "applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn". Thus questions heretofore litigated as to whether ordinary indorsements "for deposit", "for collection" or in blank have the effect of creating an agency status or a purchase, no longer have significance in varying the prima facie rule of agency. Similarly, the nature of the credit given for an item or whether it is subject to immediate withdrawal as of right or is in fact withdrawn, does not rebut the general presumption. See A.L.R. references *supra* in Comment 1.

A contrary intent can rebut the presumption but this must be clear. An example of a clear contrary intent would be if collateral papers established or the item bore a legend stating that the item was sold absolutely to the depository bank.

3. The prima facie agency status of collecting banks is consistent with prevailing law and practice today. Section 2 of the American Bankers Association Bank Collection Code so provides. Leg-

ends on deposit tickets, collection letters and acknowledgments of items and Federal Reserve operating letters consistently so provide. The status is consistent with rights of chargeback (Section 4—212 and Section 11 of the ABA Code) and risk of loss in the event of insolvency (Section 4—214 and Section 13 of the ABA Code).

4. Affirmative statement of a prima facie agency status for collecting banks requires certain limitations and qualifications. Under current practices substantially all bank collections sooner or later merge into bank credits, at least if collection is effected. Usually, this takes place within a few days of the initiation of collection. An intermediary bank receives final collection and evidences the result of its collection by a "credit" on its books to the depository bank. The depository bank evidences the results of its collection by a "credit" in the account of its customer. As used in these instances the term "credit" clearly indicates a debtor-creditor relationship. At some stage in the bank collection process the agency status of a collecting bank changes to that of debtor, a debtor of its customer. Usually at about the same time it also becomes a creditor for the amount of the item, a creditor of some intermediary, payor or other bank. Thus the collection is completed, all agency aspects are terminated and the identity of the item has become completely merged in bank accounts, that of the customer with the depository bank and that of one bank with another.

Although Section 4—213(1) provides that an item is finally paid when the payor bank takes certain action with respect to the item such final payment of the item may or may not result in the simultaneous *final settlement* for the item in the case of all prior parties. If a series of provisional debits and credits for the item have been entered in accounts between banks, the final payment of the item by the payor bank may result in the automatic firming up of all these provisional debits and credits under Section 4—213 (2), and the consequent receipt of final settlement for the item by each collecting bank and the customer of the depository bank simultaneously with such action of the payor bank. However, if the payor bank or some intermediary bank accounts for the item with a remittance draft, the next prior bank usually does not receive final settlement for the item until such remittance draft finally clears. See Section 4—211(3) (a). The



first sentence of subsection (1) provides that the agency status of a collecting bank (whether intermediary or depository) continues until the settlement *given by it for the item* is or becomes final referring to Sections 4—211(3), 4—212, and 4—213. In the case of the series of provisional credits covered by Section 4—213(2), this could be simultaneously with the final payment of the item by the payor bank. In cases where remittance drafts are used or in straight non-cash collections, this would not be until the times specified in Sections 4—211(3) and 4—213(3).

A number of practical results flow from this rule continuing the agency status of a collecting bank until its settlement for the item is or becomes final, some of which are specifically set forth in this Article. One is that risk of loss continues in the owner of the item rather than the agent bank. See Section 4—212. Offsetting rights favorable to the owner are that pending such final settlement, the owner has the preference rights of Section 4—214 and the direct rights of Section 4—302 against the payor bank. It also follows from this rule that the dollar limitations of Federal Deposit Insurance are measured by the claim of the owner of the item rather than that of the collecting bank.

5. In those cases where some period of time elapses between the final payment of the item by the payor bank and the time that the settlement of the collecting bank is or becomes final, e. g., where the payor bank or an intermediary bank accounts for the item with a remittance draft or in straight non-cash collections, the continuance of the agency status of the collecting bank necessarily carries with it the continuance of the owner's status as principal. The second sentence of subsection (1) provides that whatever rights the owner has to proceeds of the item are subject to the rights of collecting bank for outstanding advances on the item and other valid rights, if any. The rule provides a sound rule to govern cases of attempted attachment of proceeds of a non-cash item in the hands of the payor bank as property of the absent owner. If a collecting bank has made an advance on an item which is still outstanding, its right to obtain reimbursement for this advance should be superior to the rights of the owner to the proceeds or to the rights of a creditor of the owner. The phrase "other valid rights, if any" is broad enough to cover legitimate rights of set-off of accounts between banks with-

out attempting to provide that all set-offs may be valid. An intentional crediting of proceeds of an item to the account of a prior bank known to be insolvent, for the purpose of acquiring a right of set-off, would not produce a valid set-off. See 8 Zollman, Banks and Banking (1936) Sec. 5443.

6. This section and Article 4 as a whole represent an intentional abandonment of the approach to bank collection problems appearing in Section 4 of the American Bankers Association Bank Collection Code. Where the tremendous volume of items handled makes impossible the examination by all banks of all indorsements on all items and where in fact this examination is not made, except perhaps by depository banks, it is unrealistic to base the rights and duties of all banks in the collection chain on variations in the form of indorsements. It is anomalous to provide throughout the ABA Code that the *prima facie* status of collecting banks is that of agent or sub-agent but in Section 4 to provide that subsequent holders (sub-agents) shall have the right to rely on the presumption that the bank of deposit (the primary agent) is the owner of the item. It is unrealistic, particularly in this background, to base rights and duties on status of agent or owner. This Section 4—201 makes the pertinent provisions of Article 4 applicable to substantially all items handled by banks for presentment, payment or collection, recognizes the *prima facie* status of most banks as agents, and then seeks to state appropriate limits and some attributes to the general rules and presumptions so expressed.

7. Subsection (2) protects the ownership rights with respect to an item indorsed "pay any bank or banker" or in similar terms of a customer initiating collection or of any bank acquiring a security interest under Section 4—208, in the event the item is subsequently acquired under improper circumstances by a person who is not a bank and transferred by that person to another person, whether or not a bank. Upon return to the customer initiating collection of an item so indorsed, the indorsement may be cancelled (Section 3—208) A bank holding an item so indorsed may transfer the item out of banking channels by special indorsement; however, under Section 4—103(5), such bank would be liable to the owner of the item for any loss resulting therefrom if the transfer had been made in bad faith or with lack of ordinary care. If briefer and more simple forms of bank indorsements are developed under Section 4—206

(e. g., the use of bank transit numbers in lieu of present lengthy forms of bank indorsements), a depositary bank having the transit number "X100" could make subsection (2) operative by indorsements such as "Pay any bank—X100".

**Cross references:**

Sections 3—206, 3—208, 4—103, 4—206, 4—208, 4—212, 4—213, 4—214, 4—302.

**Definitional cross references:**

"Bank". Section 1—201.

"Collecting bank". Section 4—105.

"Customer". Section 4—104.

"Depositary bank". Section 4—105.

"Holder". Section 1—201.

"Item". Section 4—104.

"Indorsements". Sections 3—202, 3—204, 3—205 and 3—206.

"Person". Section 1—201.

"Settle". Section 4—104.

### NORTH CAROLINA COMMENT

The major emphasis of this section is in the last sentence of subsection (1), which states that the rules of article 4 apply regardless of whether a bank in the collection chain is an agent or an owner.

For residual areas not covered by specific rules, questions of agency or ownership status may still be important. A partial solution to these vital agency-ownership questions is found in sentences one and two of subsection (1) which in effect state:

(1) A bank is to be treated as an agent or subagent of the owner unless a contrary intent clearly appears.

(2) This agency relationship continues until settlements become final.

(3) Settlements are only provisional unless a contrary intent clearly appears.

(4) The form of indorsement or lack of

indorsement does not affect agency or ownership status.

(5) Even though bank is a mere agent, it will have certain rights in the instrument (see GS 25-4-208 on security interest and GS 25-4-209 on bank as HDC).

Generally, this section is consistent with prevailing law and practice in the United States today; and it helps to clarify some uncertain areas of North Carolina law. See several North Carolina cases on agency problem digested in North Carolina Digest, Banks and Banking, Key Numbers 156 and 159.

Subsection (2) states the rule governing the rights of parties to an instrument containing words "pay any bank" or the like.

### § 25-4-202. Responsibility for collection; when action seasonable.—

(1) A collecting bank must use ordinary care in

(a) presenting an item or sending it for presentment; and

(b) sending notice of dishonor or nonpayment or returning an item other than a documentary draft to the bank's transferor or directly to the depositary bank under subsection (2) of § 25-4-212 after learning that the item has not been paid or accepted, as the case may be; and

(c) settling for an item when the bank receives final settlement; and

(d) making or providing for any necessary protest; and

(e) notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.

(2) A collecting bank taking proper action before its midnight deadline following receipt of an item, notice or payment acts seasonably; taking proper action within a reasonably longer time may be seasonable but the bank has the burden of so establishing.

(3) Subject to subsection (1) (a), a bank is not liable for the insolvency, neglect, misconduct, mistake or default of another bank or person or for loss or destruction of an item in transit or in the possession of others. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see Sections 5 and 6, American Bankers Association Bank Collection Code.

**Purposes:**

1. Subsection (1) states the basic responsibilities of a collecting bank. Of course, under Section 1—203 a collecting bank is subject to the standard require-

ment of good faith. By subsection (1) it must also use ordinary care in the exercise of its basic collection tasks. By Section 4—103(1) neither requirement may be disclaimed.

2. If the bank makes presentment itself, subsection 1(a) requires ordinary care with respect both to the time and manner

of presentment. (Sections 3—503, 3—504, 4—201.) If it forwards the item to be presented the subsection requires ordinary care with respect to routing (Section 4—204), and also in the selection of intermediary banks or other agents.

3. Subsection (1) describes *types* of basic action with respect to which a collecting bank must use ordinary care. Subsection (2) deals with the *time* for taking action. It first prescribes the general standard for seasonable action, namely, for items received on Monday, proper action (such as forwarding or presenting) on Monday or Tuesday is seasonable. Although under current “production line” operations banks customarily move items along on regular schedules substantially briefer than two days, the subsection states an outside time within which a bank may know it has acted seasonably. To provide flexibility from this standard norm, the subsection further states that action within a reasonably longer time may be seasonable but the bank has the burden of proof. In the case of time items, action after the midnight deadline, but sufficiently in advance of maturity for proper presentation, is a clear example of a “reasonably longer time” that is seasonable. The standard of requiring action not later than Tuesday in the case of Monday items is also subject to possibilities of variation under the general provisions of

Section 4—103, or under the special provisions regarding time of receipt of items (Section 4—107), and regarding delays (Section 4—108). This subsection (2) deals only with collecting banks. The time limits applicable to payor banks appear in Sections 4—301 and 4—302.

4. At common law the so-called New York collection rule subjected the initial collecting bank to liability for the actions of subsequent banks in the collection chain; the so-called Massachusetts rule was that each bank, subject to the duty of selecting proper intermediaries, was liable only for its own negligence. Subsection (3) adopts the Massachusetts rule. But since this is stated to be subject to subsection (1) (a) a collecting bank remains responsible for using ordinary care in selecting properly qualified intermediary banks and agents and in giving proper instructions to them.

#### Cross references:

Sections 1—203, 4—103, 4—107, 4—108, 4—301 and 4—302.

#### Definitional cross references:

“Collecting bank”. Section 4—105.

“Depository bank”. Section 4—105.

“Documentary draft”. Section 4—104.

“Item”. Section 4—104.

“Midnight deadline”. Section 4—104.

“Presentment”. Article 3, Part 5.

“Protest”. Section 3—509.

### NORTH CAROLINA COMMENT

*Subsection (1):* This simply states a bank's general duty to use ordinary care.

Since direct return procedures are used in North Carolina, the phrase relating thereto has been included in subsection (1) (b).

*Subsection (2):* This prescribes the general *time* for seasonable action. “Midnight deadline” is defined in GS 25-4-104 (1) (h).

This subsection applies only to “collecting banks.” Time limits for “payor banks” appear in GS 25-4-301 and 25-4-302.

*Subsection (3):* This adopts the so-called “Massachusetts” rule of agency under which a collecting agent bank is responsible only for its own negligence and not that of subagents. This was the North Carolina rule of agency for bank collections.

**§ 25-4-203. Effect of instructions.**—Subject to the provisions of article 3 concerning conversion of instruments (§ 25-3-419) and the provisions of both article 3 and this article concerning restrictive indorsements only a collecting bank's transferor can give instructions which affect the bank or constitute notice to it and a collecting bank is not liable to prior parties for any action taken pursuant to such instructions or in accordance with any agreement with its transferor. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see Section 2 of the American Bankers Association Bank Collection Code.

#### Purposes:

This section adopts a “chain of command” theory which renders it unnecessary for an intermediary or collecting

bank to determine whether its transferor is “authorized” to give the instructions. Equally the bank is not put on notice of any “revocation of authority” or “lack of authority” by notice received from any other person. The desirability of speed in the collection process and the fact that,



by reason of advances made, the transferor may have the paramount interest in the item requires the rule.

The section is made subject to the provisions of Article 3 concerning conversion of instruments (Section 3—419) and other provisions of Article 3 and this Article concerning restrictive indorsements (Sections 3—205, 3—206, 3—419, 3—603, 4—205). Of course instructions from or an agreement with its transferor does not relieve a collecting bank of its general obligation to exercise good faith and ordinary care. See Section 4—103(1). If in any particular case a bank has exercised good faith and ordinary care and is relieved of responsibility by reason of instructions of or an agreement with its transferor, the owner of the item may still have a remedy from loss against the

transferor (another bank) if such transferor has given wrongful instructions.

The rules of the section are applied only to collecting banks. Payor banks always have the problem of making proper payment of an item; whether such payment is proper should be based upon all of the rules of Articles 3 and 4 and all of the facts of any particular case, and should not be dependent exclusively upon instructions from or an agreement with a person presenting the item.

#### Cross references:

Sections 3—205, 3—206, 3—419, 3—603, 4—103(1) and 4—205.

#### Definitional cross references:

"Collecting bank". Section 4—105.

"Restrictive indorsement". Section 3—205.

### NORTH CAROLINA COMMENT

This section adopts a "chain of command" theory which makes it unnecessary for an intermediary or collecting bank to determine whether its immediate transferor is authorized to give particular instructions.

Basically, the section requires such bank to follow only the instructions of its immediate transferor; and the bank is protected when it does so. There are two ex-

ceptions when a bank is not necessarily safe in following only the orders of its immediate transferor: (a) Conversion situations under GS 25-3-419; and (b) restrictive indorsement problems under articles 3 and 4. (See GS 25-3-205, 25-3-206, 25-3-419, 25-3-603, 25-4-205.)

The section does not apply to "payor banks" which have greater duties under other provisions of articles 3 and 4.

**§ 25-4-204. Methods of sending and presenting; sending direct to payor bank.** — (1) A collecting bank must send items by reasonably prompt method taking into consideration any relevant instructions, the nature of the item, the number of such items on hand, and the cost of collection involved and the method generally used by it or others to present such items.

(2) A collecting bank may send

- (a) any item direct to the payor bank;
- (b) any item to any non-bank payor if authorized by its transferor; and
- (c) any item other than documentary drafts to any non-bank payor, if authorized by federal reserve regulation or operating letter, clearing house rule or the like.

(3) Presentment may be made by a presenting bank at a place where the payor bank has requested that presentment be made. (1921, c. 4, s. 39; C. S., s. 220(n); 1949, c. 818; 1965, c. 700, s. 1.)

**Dealings Presumed to Contemplate Statute.** — Banks must be presumed to have dealt with each other with respect to a statute of the state in which a check was deposited for collection, defining the rights and liabilities of banks to which checks are forwarded for collection. *Federal Land Bank v. Barrow*, 189 N.C. 303, 127 S.E. 3 (1925), citing *Malloy v. Federal Reserve Bank*, 281 Fed. 997 (E.D.N.C. 1922).

**Sending Check to Drawee Bank Is Proper.**—Under the former statute, § 53-58, the sending of a cashier's check by the forwarding bank to the drawee bank for collection was held "due diligence." *Fed-*

*eral Land Bank v. Barrow*, 189 N.C. 303, 127 S.E. 3 (1925).

A collecting bank makes a good presentment of a check for payment by forwarding it to the drawee bank in another city by mail. *Braswell v. Citizens Nat'l Bank*, 197 N.C. 229, 148 S.E. 236 (1929).

**Risk of Accepting Anything but Money Not Affected.**—The former statute, § 53-58, was applicable only when the liability of a bank which had received for collection or deposit a check drawn on a bank located in another city or town to the holder or depositor of the check was involved. The statute could not be held to

affect the right of the drawer of the check to have the payee or his agent for collection demand money in payment of his check or take the risk of accepting any-

thing but money. *Dewey Bros. v. Margolis*, 195 N.C. 307, 142 S.E. 22 (1928). See § 25-4-211.

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see Section 6, American Bankers Association Bank Collection Code.

#### Purposes:

1. Subsection (1) prescribes the general standards applicable to proper sending or forwarding of items. Because of the many types of methods available and the desirability of preserving flexibility any attempt to prescribe limited or precise methods is avoided.

2. Subsection (2) (a) codifies the practice of direct mail, express, messenger or like presentment to payor banks. The practice is now country-wide and is justified by the need for speed, the general responsibility of banks, Federal Deposit Insurance protection and other reasons.

3. Full approval of the practice of direct sending is limited to cases where a bank is a payor. Where non-bank drawees or payors may be of unknown responsibility, substantial risks may be attached to placing in their hands the instruments calling for payments from them. This is obviously so in the case of documentary drafts. However, in some cities practices have long existed under clearing house procedures to forward certain types of items to certain non-bank payors. Examples include insurance loss drafts drawn by field agents on home offices. For the purpose of leaving the door open to legitimate practices of this kind, subsection (2) (c) affirmatively approves direct sending of any item other than documentary drafts to any non-bank payor, if authorized by Federal Reserve regulation or operating letter, clearing house rule or the like.

On the other hand subsection (2) (b) approves sending any item direct to a non-bank payor if authorized by a collecting bank's transferor. This permits special instructions or agreements out of the norm and is consistent with the "chain of command" theory of Section 4—203. However, if a transferor other than the owner of the item, e. g., a prior collecting bank, authorizes a direct sending to a non-bank payor, such transferor assumes responsibility for the propriety or impropriety of such authorization.

4. Section 3—504 states how presentment is made and subsection (2) of that section affirmatively approves three specific methods by which presentment may be made. The methods so specified are permissive and do not foreclose other possible methods. However, in view of the substantial increase in recent years of presentment at centralized bookkeeping centers and electronic processing centers maintained or used by payor banks, many of which are at locations other than the banks themselves, subsection (3) specifically approves presentment by a presenting bank at any place requested by the payor bank.

#### Cross references:

Sections 3—504, 4—501 and 4—502.

#### Definitional cross references:

"Collecting bank". Section 4—105.

"Documentary draft". Section 4—104.

"Item". Section 4—104.

"Payor bank". Section 4—105.

"Presenting bank". Section 4—105.

### NORTH CAROLINA COMMENT

*Subsection (1):* This simply states a general rule demanding reasonably prompt forwarding of items, taking into account all relevant factors.

*Subsection (2):* (a) Continues the rule GS 53-58 permitting direct presentment to a payor bank.

Subsequent study may reveal that this

subsection needs to be expanded to expressly approve other direct presentments for instruments payable "at" or "through" a bank.

(b) and (c) Permit direct presentment to nonbank payors only when such direct presentment is authorized.

**§ 25-4-205. Supplying missing indorsement; no notice from prior indorsement.**—(1) A depository bank which has taken an item for collection may supply any indorsement of the customer which is necessary to title unless the item contains the words "payee's indorsement required" or the like. In the absence of such a requirement a statement placed on the item by the depository bank to the effect that the item was deposited by a customer or credited to his account is effective as the customer's indorsement.

(2) An intermediary bank, or payor bank which is not a depositary bank, is neither given notice nor otherwise affected by a restrictive indorsement of any person except the bank's immediate transferor. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. Subsection (1) is designed to speed up collections by eliminating any necessity to return to a non-bank depositor any items he may have failed to indorse.

2. For the purpose of permitting items to move rapidly through banking channels, intermediary banks and payor banks which are not also depositary banks are permitted to ignore restrictive indorsements of any person except the bank's immediate transferor. However, depositary banks may not so ignore restrictive indorsements. If an owner of an item indorses it "for deposit" or "for collection" he usually does so in the belief such indorsement will guard against further

negotiation of the item to a holder in due course by a finder or a thief. This belief is reasonably justified if at least one bank in any chain of banks collecting the item has a responsibility to act consistently with the indorsement.

**Cross references:**

Sections 3—205, 3—206, 3—419, 3—603, 4—203.

**Definitional cross references:**

"Collecting bank." Section 4—105.

"Customer." Section 4—104.

"Depositary bank." Section 4—105.

"Intermediary bank." Section 4—105.

"Item." Section 4—104.

"Payor bank." Section 4—105.

"Restrictive indorsement." Section 3—205.

#### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection permits a missing indorsement to be supplied by a depositary bank (i.e., "the first bank to which an item is transferred for collection," GS 25-4-105 (a)).

Presumably, subsequent banks that take "negotiable instruments" containing either of the two authorized types of substitute indorsements will be "holders" and may be HDC's under GS 25-4-208 and 25-4-209. Also see GS 25-4-206 on a "transfer" that is not a "negotiation."

Note that a depositary bank may only supply an "indorsement of the customer which is necessary for title." Thus:

(1) On *bearer* paper (for which no indorsement is necessary to transfer title) the contract of a customer may not be enlarged to those of an indorser (GS 25-3-414) by the indorsement of the bank. However, he still makes the warranties of GS 25-3-417 (2) and 25-4-207, and

(2) Also the bank is not authorized to supply the indorsement of any party prior to the customer who presents the item for collection.

(3) Furthermore, it appears that this section does not apply to indorsement of one who "cashes" a check.

*Possible amendment note:* There is some doubt whether a signature is ever really necessary to pass title (GS 25-3-201); and further study may reveal that subsection (1) (a) needs to be amended.)

*Subsection (2):* This in effect restates the rule of GS 25-3-206 on the limited effect of restrictive indorsements. The two sections differ as follows:

(1) GS 25-3-206 applies only to negotiable instruments, while GS 25-4-205 applies to any "item."

(2) GS 25-3-206 (2) adds the words "or the person presenting for payment."

**§ 25-4-206. Transfer between banks.**—Any agreed method which identifies the transferor bank is sufficient for the item's further transfer to another bank. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

This section is designed to permit the simplest possible form of transfer from one bank to another, once an item gets in the bank collection chain, provided only identity of the transferor bank is preserved. This is important for tracing purposes and if recourse is necessary.

However, since the responsibilities of the various banks appear in the Article it becomes unnecessary to have liability or responsibility depend on more formal indorsements. Simplicity in the form of transfer is conducive to speed. Where the transfer is between banks this section takes the place of the more formal requirements of Section 3—202.



**Cross references:**

Sections 3—201, 3—202.

**Definitional cross references:**

“Bank”. Section 1—201.

“Item”. Section 4—104.

**NORTH CAROLINA COMMENT**

This permits a *transfer* without the indorsement of the transferor. However, it does not mean that a mere identification of the transferor is the equivalent of an indorsement so as to have a negotia-

tion of a negotiable instrument. Thus, a bank taking under this informal procedure cannot be a *holder* unless the instrument is bearer paper.

**§ 25-4-207. Warranties of customer and collecting bank on transfer or presentment of items; time for claims.**—(1) Each customer or collecting bank who obtains payment or acceptance of an item and each prior customer and collecting bank warrants to the payor bank or other payor who in good faith pays or accepts the item that

(a) he has a good title to the item or is authorized to obtain payment or acceptance on behalf of one who has a good title; and

(b) he has no knowledge that the signature of the maker or drawer is unauthorized, except that this warranty is not given by any customer or collecting bank that is a holder in due course and acts in good faith

(i) to a maker with respect to the maker's own signature; or

(ii) to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee; or

(iii) to an acceptor of an item if the holder in due course took the item after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorized; and

(c) the item has not been materially altered, except that this warranty is not given by any customer or collecting bank that is a holder in due course and acts in good faith

(i) to the maker of a note; or

(ii) to the drawer of a draft whether or not the drawer is also the drawee; or

(iii) to the acceptor of an item with respect to an alteration made prior to the acceptance if the holder in due course took the item after the acceptance, even though the acceptance provided “payable as originally drawn” or equivalent terms; or

(iv) to the acceptor of an item with respect to an alteration made after the acceptance.

(2) Each customer and collecting bank who transfers an item and receives a settlement or other consideration for it warrants to his transferee and to any subsequent collecting bank who takes the item in good faith that

(a) he has a good title to the item or is authorized to obtain payment or acceptance on behalf of one who has a good title and the transfer is otherwise rightful; and

(b) all signatures are genuine or authorized; and

(c) the item has not been materially altered; and

(d) no defense of any party is good against him; and

(e) he has no knowledge of any insolvency proceeding instituted with respect to the maker or acceptor or the drawer of an unaccepted item.

In addition each customer and collecting bank so transferring an item and receiving a settlement or other consideration engages that upon dishonor and any necessary notice of dishonor and protest he will take up the item.

(3) The warranties and the engagement to honor set forth in the two preceding subsections arise notwithstanding the absence of indorsement or words of guaranty or warranty in the transfer or presentment and a collecting bank remains liable for their breach despite remittance to its transferor. Damages for breach of such warranties or engagement to honor shall not exceed the consideration received by the

customer or collecting bank responsible plus finance charges and expenses related to the item, if any.

(4) Unless a claim for breach of warranty under this section is made within a reasonable time after the person claiming learns of the breach, the person liable is discharged to the extent of any loss caused by the delay in making claim. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see American Bankers Association Bank Collection Code, Section 4.

##### Purposes:

1. Subject to certain exceptions peculiar to the bank collection process and except that they apply only to customers and collecting banks, the warranties and engagements to honor in this section are identical in substance with those provided in the Article on Commercial Paper (Article 3). See Sections 3—414, 3—417. For a more complete explanation of the purposes of these warranties and engagements see the Comments to Sections 3—414 and 3—417.

2. In addition to imposing upon customers and collecting banks the warranties and engagements imposed by the original Sections 65 and 66 of the Uniform Negotiable Instruments Law and those of Sections 3—414 and 3—417 of Article 3, with some variations, this Section 4—207 is intended to give the effect presently obtained in bank collections by the words "prior indorsements guaranteed" in collection transfers and presentments between banks. The warranties and engagements arise automatically as a part of the bank collection process. Receipt of a settlement or other consideration by a customer or collecting bank is a requirement but any settlement is sufficient regardless of whether the settlement is concurrent with the transfer, as in the case of a cash item, or delayed, as in the case of a non-cash straight collection item. Further, the warranties and engagements run with the item with the result that a collecting bank may sue a remote prior collecting bank or a remote customer and thus avoid multiplicity of suits. This section is also intended to make it clear that the so-called equitable defense of "payment over" does not apply to a collecting bank and that no statute of frauds provision will defeat recovery. Subsections (2) and (3) indicate that these results are intended notwithstanding the absence of indorsement or words of guarantee or warranty in a transfer or presentment. Consequently, if for purposes of simplification or the speeding up of the bank collection process, banks desire to cut down the length or size of indorsements (Sec-

tion 4—206), they may do so and the standard warranties and engagements to honor still apply.

3. With respect to the exceptions to the warranties in favor of a holder in due course specified in sub-paragraphs (b) and (c) of subsection (1), collecting banks usually have holder in due course status (Sections 4—208, 4—209). However, if in any case there is a holder in due course but a subsequent collecting bank does not have holder in due course status (e. g., in a straight non-cash collection where no settlement of any kind is made until the bank itself receives final settlement) the bank still has the benefit of the exceptions (if it acts in good faith) under the shelter provisions of Section 3—201. It is to be noted that these shelter provisions, by virtue of successive transfers, benefit not only the immediate transferee from a holder in due course but also subsequent transferees.

4. In this section as in Section 3—417, the (a), (b) and (c) warranties to transferees and collecting banks under subsection (2) are in general similar to the (a), (b) and (c) warranties to payors under subsection (1); but the warranties to payors are less inclusive because of exceptions reflecting the rule of *Price v. Neal*, 3 Burr. 1354 (1762), and related principles. See Comment to Section 3—417. Thus collecting banks are given not only all the warranties given to payors by subsection (1), without those exceptions, but also the (d) and (e) warranties of subsection (2).

5. The last sentence of subsection (3) provides that damages for breach of warranties or the engagement to honor shall not exceed the consideration received by the customer or collecting bank responsible "plus finance charges and expenses related to the item, if any". The "expenses" referred to in this phrase may be ordinary collecting expenses and in appropriate cases could also include such expenses as attorneys' fees. "Finance charges" are also referred to because in some cases interest or a finance charge is charged by the collecting bank for the time that the bank's advance on the item is outstanding prior to receipt of proceeds

of collection. An example of this type of case would be where a bank undertakes a foreign collection in South America or Europe and makes an advance on the item at the time of receipt but may not receive proceeds of the foreign collection for three months or more.

**Cross references:**

Sections 3—201, 3—414, 3—417, 3—418, 4—206, 4—208, 4—209 and 4—406.

**Definitional cross references:**

“Collecting bank”. Section 4—105.

“Customer”. Section 4—104.

“Draft”. Section 3—104.

“Genuine”. Section 1—201.

“Good faith”. Section 1—201.

“Holder”. Section 1—201.

“Holder in due course”. Section 3—302.

“Insolvency proceedings”. Section 1—201.

“Item”. Section 4—104.

“Party”. Section 1—201.

“Payor bank”. Section 4—105.

“Person”. Section 1—201.

“Presentment”. Section 3—504.

“Protest”. Section 3—509.

“Unauthorized signature”. Section 1—201.

### NORTH CAROLINA COMMENT

*Subsections (1), (2) and (3):* The warranty provisions of these subsections are extensive; and they apply to both negotiable and nonnegotiable instruments. By comparison the substantially similar warranties of GS 25-3-417 apply only to negotiable instruments.

Note that the warranties of this section apply regardless of the type of indorsement or whether there was an indorsement. This differs from GS 25-3-417, which varies the quantity of warranties according to the type of indorsement.

A detailed analysis of the elaborate warranty provisions of subsections (1), (2) and (3) is beyond the scope of this preliminary commentary. However, for those who wish to more fully explore this section, and related GS 25-3-417, reference is made to the comprehensive New Jersey

Study 308-314, 391-393; and to Clarke, Bailey, and Young, *Bank Deposits and Collections—UCC 130-143* (1963).

In addition to providing for various warranties, the last sentence of subsection (2) creates a *contract* for each customer and collecting bank that transfers an item and receives consideration. Each such party “*engages* that upon dishonor and any necessary notice of dishonor and protest he will *take up* the item.”

The “take up” requirement of subsection (2) should be compared with the limited damages provision of subsection (3).

*Subsection (4):* This subsection grants a limited discharge to a warrantor who is damaged by unreasonable delay of a warrantee in making claim for breach of warranty.

**§ 25-4-208. Security interest of collecting bank in items, accompanying documents and proceeds.**—(1) A bank has a security interest in an item and any accompanying documents or the proceeds of either

(a) in case of an item deposited in an account to the extent to which credit given for the item has been withdrawn or applied;

(b) in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given whether or not the credit is drawn upon and whether or not there is a right of charge-back; or

(c) if it makes an advance on or against the item.

(2) When credit which has been given for several items received at one time or pursuant to a single agreement is withdrawn or applied in part the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(3) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents and proceeds. To the extent and so long as the bank does not receive final settlement for the item or give up possession of the item or accompanying documents for purposes other than collection, the security interest continues and is subject to the provisions of article 9 except that

(a) no security agreement is necessary to make the security interest enforceable (subsection (1) (b) of § 25-9-203); and

(b) no filing is required to perfect the security interest; and

(c) the security interest has priority over conflicting perfected security interests in the item, accompanying documents or proceeds. (1965, c. 700, s. 1.)



## OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see American Bankers Association Bank Collection Code, Section 2.

**Purposes:**

1. Subsection (1) states a rational rule for the interest of a bank in an item. The customer of the depository bank is normally the owner of the item and the several collecting banks are his agents (Section 4—201). A collecting agent may properly make advances on the security of paper held by him for collection, and when he does acquires at common law a possessory lien for his advances. Subsection (1) applies an analogous principle to a bank in the collection chain which extends credit on items in the course of collection. The bank has a security interest to the extent stated in this section. To the extent of its security interest it is a holder for value (Sections 3—303, 4—209) and a holder in due course if it satisfies the other requirements for that status (Section 3—302). Subsection (1) does not derogate from the banker's general common-law lien or right of set-off against indebtedness owing in deposit accounts. See Section 1—103. Rather subsection (1) specifically implements and

extends the principle as a part of the bank collection process.

2. Subsection (2) spreads the security interest of the bank over all items in a single deposit or received under a single agreement and a single giving of credit. It also adopts the "first-in, first-out" rule.

3. Collection statistics establish that in excess of ninety-nine per cent of items handled for collection are in fact collected. The first sentence of subsection (3) reflects the fact that in such normal case the bank's security interest is self-liquidating. The remainder of the subsection correlates the security interest with the provisions of Article 9, particularly for use in the cases of non-collection where the security interest may be important.

**Cross references:**

Sections 3—302, 3—303, 4—201, 4—209, 9—203(1) (b) and 9—302.

**Definitional cross references:**

"Account". Section 4—104.

"Agreement". Section 1—201.

"Bank". Section 1—201.

"Item". Section 4—104.

"Security interest". Section 1—201.

"Settlement". Section 4—104.

## NORTH CAROLINA COMMENT

*Subsection (1):* This important section gives a bank a security interest in various items; thus enabling a bank to be protected against other claims against items and proceeds; also, the security interest will permit a bank to be a holder for value and perhaps an HDC under GS 25-4-209.

Because the HDC problem is one of the most important covered by GS 25-4-208 and 25-4-209, the two sections are considered together here. By reading these two sections together, it is clear that even a collecting bank may possibly be an HDC; and often the most important facet of the HDC issue is whether the bank is a holder for value.

Past North Carolina decisions have been rather vague in determining whether a collecting bank can be an HDC:

(a) A bank taking for collection is not an HDC. *Manufacturers Fin. Co. v. Amazon Cotton Mills Co.*, 187 N.C. 233, 121 S.E. 439 (1924); *First Nat'l Bank v. Rochamora*, 193 N.C. 1, 136 S.E. 259 (1927).

(b) A bank may be HDC of draft even though custom permits a charge back against depositor. *Elm City Lumber Co. v. Childerhouse*, 167 N.C. 34, 83 S.E. 22 (1914).

(c) Bank may be HDC of check even when it charges back against depositor's

account if amounts against which charge back is made are later removed when items representing amounts are returned unpaid. *Standard Trust Co. v. Commercial Nat'l Bank*, 240 Fed. 303 (4th Cir. 1917).

(d) A bank which reserves a right to charge back, by express agreement or one implied from a course of dealing, and not by reason of liability on the indorsement, is an agent for collection and not a purchaser. *Manufacturers Fin. Co. v. Amazon Cotton Mills Co.*, 187 N.C. 233, 121 S.E. 439 (1924).

(e) Regardless of formal statements on a deposit slip that deposits are accepted for collection only, "if the facts and circumstances surrounding the making of the deposit indicate *at the time it was made* it was the *actual agreement and intention* of the parties that the depositor might withdraw completely the deposit, or otherwise completely employ it, and he does so, the title to the item deposited thereupon passes to the bank"; and it may be an HDC. (Emphasis added.) *State Planters Bank v. Courtesy Motors, Inc.*, 250 N.C. 466, 109 S.E.2d 189 (1959).

(f) Where bank permits an uncollected draft received for deposit and collection to be drawn against, the bank has rights su-

terior to an attaching creditor of the depositor. *Ledwell v. Shenandoah Milling Co.*, 215 N.C. 371, 1 S.E.2d 841 (1939).

Despite certain inconsistencies in decisions and many unsettled areas, it seems fair to say that North Carolina has in the past usually permitted banks to be HDC's when they could not make themselves harmless by charge back against the depositor's account. GS 25-4-208 and 25-4-209 will continue and expand this principle.

In short, the new rules are:

(1) A bank in the collecting chain basically occupies a technical position of an agent only (GS 25-4-201); but

(2) it obtains certain security interests in the item under GS 25-4-208; and

**§ 25-4-209. When bank gives value for purposes of holder in due course.**—For purposes of determining its status as a holder in due course, the bank has given value to the extent that it has a security interest in an item provided that the bank otherwise complies with the requirements of § 25-3-302 on what constitutes a holder in due course. (1899, c. 733, s. 27; Rev., s. 2175; C. S., s. 3007; 1965, c. 700, s. 1.)

**Deposit of Draft for Collection.** — If drafts, deposited by a customer for his credit, returned unpaid, are charged back to the customer's account, and returned to him, this constitutes only an agency for collection. *Latham v. Spragins*, 162 N.C. 404, 78 S.E. 282 (1913).

**Application of Proceeds of Draft to Antecedent Debt.** — If the drawer of a draft was in debt to the bank, and the draft was discounted by it and the proceeds applied in discharge of such balance, the bank became the owner of the draft, and a purchaser for value to the extent of the goods

(3) under GS 25-4-209 it becomes a holder for value and may be an HDC.

See also North Carolina Comment to GS 25-4-209.

**Subsection (2):** This subsection adopts the first-in, first-out (FIFO) rule for determining when credits have been drawn against. This rule applies to all of GS 25-4-208. To the same effect is *Standing Stone Nat'l Bank v. Walser*, 162 N.C. 53, 77 S.E. 1006 (1913).

**Subsection (3):** In this subsection (a) and (b) state that no security agreement or filing under article 9 is necessary to perfect a bank's security interest. (3) (c) gives a bank a priority over other competing security interests.

described in the bills of lading. *Latham v. Spragins*, 162 N.C. 404, 78 S.E. 282 (1913).

**Assignment of Draft to Bank for Valuable Consideration.**—Where a bank for a valuable consideration takes an assignment of a bill of lading with draft attached, the consignee of the goods takes them subject to the rights of the holder of the bill of lading for the amount of the draft, and he cannot retain the price of the goods on account of a debt due him from the consignor. *Willard Mfg. Co. v. Tierney*, 133 N.C. 630, 45 S.E. 1026 (1903).

### OFFICIAL COMMENT

Prior uniform statutory provision: Negotiable Instruments Law, Section 27.

**Purpose:**

The section completes the thought of the previous section and makes clear that a security interest in an item is "value" for the purpose of determining the holder's status as a holder in due course. The provision is in accord with the prior law (N.I.L. Section 27) and with Article 3 (Section 3-303). The section does not prescribe a security interest under

Section 4-208 as a test of "value" generally because the meaning of "value" under other Articles is adequately defined in Section 1-201.

**Cross references:**

Sections 1-201, 3-302, 3-303 and 4-208.

**Definitional cross references:**

"Bank". Section 1-201.

"Holder in due course". Section 3-302.

"Item". Section 4-104.

"Security interest". Section 1-201.

### NORTH CAROLINA COMMENT

As noted in the North Carolina Comment to GS 25-4-208, this awkwardly worded section permits a bank to be a holder for value to the extent that it has a security interest as defined in GS 25-4-208.

In order to be an HDC, however, the

bank must also meet the other tests of GS 25-3-302 for HDC status.

Even though a bank does not qualify as an HDC in its own right, it may be a derivative HDC under the so-called "shelter" provisions of GS 25-3-201.

**§ 25-4-210. Presentment by notice of item not payable by, through or at a bank; liability of secondary parties.** — (1) Unless otherwise instructed, a collecting bank may present an item not payable by, through or at a bank by sending to the party to accept or pay a written notice that the bank holds the item for acceptance or payment. The notice must be sent in time to be received on or before the day when presentment is due and the bank must meet any requirement of the party to accept or pay under § 25-3-505 by the close of the bank's next banking day after it knows of the requirement.

(2) Where presentment is made by notice and neither honor nor request for compliance with a requirement under § 25-3-505 is received by the close of business on the day after maturity or in the case of demand items by the close of business on the third banking day after notice was sent, the presenting bank may treat the item as dishonored and charge any secondary party by sending him notice of the facts. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. This section codifies a practice extensively followed in presentation of trade acceptances and documentary and other drafts drawn on non-bank payors. It imposes a duty on the payor to respond to the notice of the item if the item is not to be considered dishonored. Notice of such a dishonor charges parties secondarily liable. Presentment under this section is good presentment under Article 3. See Section 3—504(5).

2. A drawee not receiving notice is not, of course, liable to the drawer for wrongful dishonor.

3. A bank so presenting an instrument

must be sufficiently close to the drawee to be able to exhibit the instrument on the day it is requested to do so or the next business day at the latest.

**Cross references:**

Sections 3—501 through 3—508, 4—501 and 4—502.

**Definitional cross references:**

"Acceptance". Section 3—410.

"Banking day". Section 4—104.

"Collecting bank". Section 4—105.

"Item". Section 4—104.

"Party". Section 1—201.

"Presentment". Section 3—504.

"Secondary party". Section 3—102.

"Send". Section 1—201.

#### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection permits a collecting bank to make a proper presentment to the party who is to pay or accept by merely sending a *written notice* that the bank holds the item for payment or acceptance. Thus, the bank need not actually present the item itself.

As implied in GS 25-4-204 (2) (b) and (c), it is often wrong for a bank to send collection items directly to a nonbank payor; and this section will allow a written notice presentment without the bank's either personally presenting or mailing the items.

However, since (1) notice must be sent in time to be received by the day when presentment is due, and (2) since the bank must permit the presentee to see the instrument, etc., as provided by GS 25-3-505 (rights of party to whom presentment is made), the presenting bank should be in a position to satisfy the demands of the presentee given under GS 25-3-505 by not

later than the close of the next day after the bank learns of the presentee's demands ("requirements").

Further study may reveal that this subsection needs to be revised to correlate more closely with GS 25-3-505.

(*Note:* This is but one of several areas where articles 3 and 4 apply somewhat different rules to a particular situation. While it is not suggested that North Carolina amend the UCC without prior consultation with the Permanent Editorial Board, we may wish to take the initiative in proposing some minor changes for action by all adopting states.)

*Subsection (2):* This subsection states the rules for treating an instrument as dishonored after "notice presentment." It further says that a bank *may* charge secondary parties by sending notice of the facts. It does not specifically state the duty of a bank to notify of the facts. This duty is partially covered by GS 25-4-202.

**§ 25-4-211. Media of remittance; provisional and final settlement in remittance cases.**—(1) A collecting bank may take in settlement of an item

(a) a check of the remitting bank or of another bank on any bank except the remitting bank; or



(b) a cashier's check or similar primary obligation of a remitting bank which is a member of or clears through a member of the same clearing house or group as the collecting bank; or

(c) appropriate authority to charge an account of the remitting bank or of another bank with the collecting bank; or

(d) if the item is drawn upon or payable by a person other than a bank, a cashier's check, certified check or other bank check or obligation.

(2) If before its midnight deadline the collecting bank properly dishonors a remittance check or authorization to charge on itself or presents or forwards for collection a remittance instrument of or on another bank which is of a kind approved by subsection (1) or has not been authorized by it, the collecting bank is not liable to prior parties in the event of the dishonor of such check, instrument or authorization.

(3) A settlement for an item by means of a remittance instrument or authorization to charge is or becomes a final settlement as to both the person making and the person receiving the settlement

(a) if the remittance instrument or authorization to charge is of a kind approved by subsection (1) or has not been authorized by the person receiving the settlement and in either case the person receiving the settlement acts seasonably before its midnight deadline in presenting, forwarding for collection or paying the instrument or authorization,—at the time the remittance instrument or authorization is finally paid by the payor by which it is payable;

(b) if the person receiving the settlement has authorized remittance by a non-bank check or obligation or by a cashier's check or similar primary obligation of or a check upon the payor or other remitting bank which is not of a kind approved by subsection (1) (b),—at the time of the receipt of such remittance check or obligation; or

(c) if in a case not covered by subparagraphs (a) or (b) the person receiving the settlement fails to seasonably present, forward for collection, pay or return a remittance instrument or authorization to it to charge before its midnight deadline,—at such midnight deadline. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see Sections 9 and 10 American Bankers Association Bank Collection Code.

##### Purposes:

1. Subsection (1) states various types of remittance instruments and authorities to charge which may be received by a collecting bank in a settlement for an item, without the collecting bank being responsible if such form of remittance is not itself paid. The action of the collecting bank in receiving these provisional forms of remittance is approved and the risk that they are not paid is placed on the owner of the item, and not on the collecting bank. Justification for these results lies in the fact that with the tremendous volume of items collected it is simply not mechanically feasible to remit or pay in money or other forms of technical "legal tender". Since it is not feasible for banks to perform their collection functions except with the use of these provisional remittances, they should not be penalized for acting in the only way they can act.

2. The first approved form of provi-

sional remittance having these results is a check of the remitting bank or of another bank on any bank except the remitting bank (subsection (1) (a)). A check on the remitting bank itself is not approved because this would merely be substituting for the original item another item on the same payor.

3. A cashier's check or similar primary obligation of the remitting bank which is a member of or clears through a member of the same clearing house or group as the collecting bank is approved by subsection (1) (b) because this is just as speedy and effective a means of settlement through a clearing house as any other type of instrument or a check on another bank. On the other hand such cashier's checks or primary obligations are not approved for use, at the owner's risk, outside a single clearing house or clearing area because when so used they do not constitute a means of final settlement but merely substitute one item on the remitting bank for another one on the same bank. To the remitting bank they may have benefit in maintaining

"float" or having the use of money even though drawn against, but this is not looked upon as sound practice.

4. Subsection (1) (d) recognizes and approves the general and consistent practice of collecting banks to accept cashier's checks, certified checks or other bank checks or obligations as a proper means of remittance from non-bank payors, with the owner of the original item carrying the risk of non-payment of these bank instruments rather than the collecting bank, to the extent there is any risk. Here again this rule and practice is justified by the fact that payment in money for all practical purposes is no longer feasible and consequently is not used except in rare instances. Subsection (1) (d) recognizes the standard medium that is used.

5. This section does not purport to deal with all kinds of settlements for items. It does not purport to deal with settlements for "cash items" (described in Comments to Section 4—212), settlements merely by debits and credits in accounts between banks (Section 4—213) or settlements through clearing houses. The section is limited to those situations where a collecting or payor bank or a non-bank payor receives an item and accounts for it by "remitting" or "sending back" something for the item, usually some form of a remittance instrument, order or authorization. Some specific rules are needed for remittance cases because of time required to process the remittance instrument.

Failure to mention in subsection (1) entries in accounts between banks and clearing house settlements carries no implication of impropriety of these types of provisional or final settlement. Approval of these means of settlement is evidenced by the definition of "settle" in Section 4—104(j), provision for charge-back and refund in Section 4—212, and provisions regarding settlements becoming final (Section 4—213). Further, the specific listing in subsection (1) of certain usual types of remittances does not imply that all other types of remittances are improper (Section 4—103(4)).

6. Subsection (2) provides that if a remittance is one of the kinds approved by subsection (1) and the collecting bank receiving the item acts seasonably in handling it before the bank's midnight deadline, the bank is not liable to prior parties in the event of dishonor. The subsection also provides for an additional situation. If without any authorization whatsoever the payor or remitting bank or person

remits with an improper remittance instrument, the collecting bank should not be penalized where it is without fault. Nevertheless, the owner of the item may not be served if the collecting bank rejects the improper instrument. In many cases the best course would be to collect the instrument as rapidly as possible. Subsection (2) provides that if this is done the collecting bank is not responsible in the event of dishonor.

7. Subsection (3) complements subsections (1) and (2) by providing when a settlement by means of a remittance instrument or authorization to charge becomes final. Subparagraph (a) provides that in situations specified in subsection (2) the settlement becomes final at the time the remittance instrument or authorization is finally paid by the payor by which it is payable. The standards determining this final payment are those prescribed in Section 4—213. Conversely, under subparagraph (b) if the person receiving the settlement has authorized remittance by certain specified media not approved by subsection (1) the settlement becomes final at the time of receipt of such check or obligation. In this event the person receiving the settlement assumes the risk that the remittance instrument is not itself paid. A prior course of dealing of receiving unapproved forms of remittances from the payor or remitting person in question would be the equivalent of an authorization and effective as such. Subparagraph (c) provides for most, if not all, remaining remittance situations. Here settlement becomes final at the midnight deadline of the person receiving the remittance.

Subsection (3) provides that the times of final settlement prescribed apply both to the person making and the person receiving the settlement. Further, by use of the term "person", these rules also apply to non-bank payors of items and non-bank customers for whom items are being collected, as well as to collecting and payor banks.

8. When settlement is by credit in an account with another bank Section 4—213 controls.

**Cross reference:**

Section 4—213.

**Definitional cross references:**

"Account". Section 4—104.

"Bank". Section 1—201.

"Clearing house". Section 4—104.

"Collecting bank". Section 4—105.

"Item". Section 4—104.

"Midnight deadline". Section 4—104.

"Money". Section 1—201.

"Payor bank". Section 4—105.

"Person". Section 1—201.

"Remitting bank". Section 4—105.

"Settle". Section 4—104.

### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection states the several appropriate settlements that can safely be taken by a collecting bank. The risk that such noncash settlements may not be realizable in cash is shifted from the collecting bank to the owner of the item.

A somewhat similar rule is found in GS 53-71; however, GS 25-4-211 (1) gives much broader protection to the collecting bank.

Under GS 53-71 the emphasis is on the propriety of noncash payments by the payor bank; and only indirectly answered are the questions of: (1) When the drawer is discharged and (2) whether the collecting bank has accepted a proper payment. (See cases annotated under GS 53-71).

Under GS 25-4-211, the emphasis is on the propriety of the acceptance of a particular medium of payment by the collecting bank. The further question of final payment by the drawer is covered in GS 25-4-213. (See North Carolina Comment).

Subsection (1) does not cover all types of settlement, and the specific listing of certain usual types of remittances does not imply that other types of remittances are improper (GS 25-4-103 (4)). See Official Comment 5.

*Subsection (2):* This subsection relieves a collecting bank from liability if an authorized noncash receipt is later dishonored.

*Subsection (3):* This subsection complements subsections (1) and (2) by stating when a settlement by means of a remittance instrument or an authorization to charge becomes final as to both the person making and the person receiving the settlement. By using the term "person" these rules apply to nonbank payors and nonbank customers for whom items are being collected, as well as to bank payors and collecting banks.

**§ 25-4-212. Right of charge-back or refund.**—(1) If a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge-back the amount of any credit given for the item to its customer's account or obtain refund from its customer whether or not it is able to return the item if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. These rights to revoke, charge-back and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final (subsection (3) of § 25-4-211 and subsections (2) and (3) of § 25-4-213).

(2) Within the time and manner prescribed by this section and § 25-4-301, an intermediary or payor bank, as the case may be, may return an unpaid item directly to the depository bank and may send for collection a draft on the depository bank and obtain reimbursement. In such case, if the depository bank has received provisional settlement for the item, it must reimburse the bank drawing the draft and any provisional credits for the item between banks shall become and remain final.

(3) A depository bank which is also the payor may charge-back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (§ 25-4-301).

(4) The right to charge-back is not affected by

(a) prior use of the credit given for the item; or

(b) failure by any bank to exercise ordinary care with respect to the item but any bank so failing remains liable.

(5) A failure to charge-back or claim refund does not affect other rights of the bank against the customer or any other party.

(6) If credit is given in dollars as the equivalent of the value of an item payable in a foreign currency the dollar amount of any charge-back or refund shall be calculated on the basis of the buying sight rate for the foreign currency prevailing on



the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see Sections 2 and 11, American Bankers Association Bank Collection Code.

**Purposes:**

1. Under current bank practice, in a major portion of cases banks make provisional settlement for items when they are first received and then await subsequent determination of whether the item will be finally paid. This is the principal characteristic of what are referred to in banking parlance as "cash items". Statistically, this practice of settling provisionally first and then awaiting final payment is justified because more than ninety-nine per cent of such cash items are finally paid, with the result that in this great preponderance of cases it becomes unnecessary for the banks making the provisional settlements to make any further entries. In due course the provisional settlements become final simply with the lapse of time. However, in those cases where the item being collected is not finally paid or where for various reasons the bank making the provisional settlement does not itself receive final payment, under the American Bankers Association Bank Collection Code, under Federal Reserve Regulations and operating letters and under various types of agreements between banks and between customers and banks, provision is made for the reversal of the provisional settlements, charge-back of provisional credits and the right to obtain refund. Subsection (1) codifies and simplifies the statement of these rights.

2. Various causes of a bank not receiving final payment, with the resulting right of charge-back or refund, are stated or suggested in subsection (1). These include dishonor of the original item; dishonor of a remittance instrument given for it; reversal of a provisional credit for the item; suspension of payments by another bank. The causes stated are illustrative; the right of charge-back or refund is stated to exist whether the failure to receive final payment in ordinary course arises through one of them "or otherwise".

3. The right of charge-back or refund exists if a collecting bank has made a provisional settlement for an item with its customer but terminates if and when a settlement received by the bank for the item is or becomes final. If the bank fails to receive such a final settlement

the right of charge-back or refund must be exercised promptly after the bank learns the facts. The right exists (if so promptly exercised) whether or not the bank is able to return the item.

4. Subsection (2) is an affirmative provision for so-called "direct returns". This is a new practice that is currently in the process of developing in a few sections of the country. Its purpose is to speed up the return of unpaid items by avoiding handling by one or more intermediate banks. The subsection is bracketed because the practice is not yet well established and some bankers and bank lawyers would prefer to let the practice develop by agreement. The contention is made that substantive rights between banks may be affected, e. g., available set-offs, but proponents contend advantages of direct returns outweigh possible detriments. However, if the subsection were omitted, the election to use direct returns would be on the depository bank and it would probably be necessary for that bank to specifically authorize direct returns with each outgoing letter. This is a cumbersome way of meeting the problem. If the subsection is retained the payor bank, unless it has been specifically directed otherwise, will have the right to make the decision whether it will return an unpaid item directly. Since the subsection is permissive and its inclusion tends toward greater flexibility, its retention is recommended.

5. The rule of subsection (4) relating to charge-back (as distinguished from claim for refund) applies irrespective of the cause of the nonpayment, and of the person ultimately liable for nonpayment. Thus charge-back is permitted even where nonpayment results from the depository bank's own negligence. Any other rule would result in litigation based upon a claim for wrongful dishonor of other checks of the customer, with potential damages far in excess of the amount of the item. Any other rule would require a bank to determine difficult questions of fact. The customer's protection is found in the general obligation of good faith (Sections 1-203 and 4-103). If bad faith is established the customer's recovery "includes other damages, if any, suffered by the party as a proximate consequence" (Section 4-103(5); see also Section 4-402).

6. It is clear that the charge-back does

not relieve the bank from any liability for failure to exercise ordinary care in handling the item. The measure of damages for such failure is stated in Section 4-103(5).

7. Subsection (6) states a rule fixing the time for determining the rate of exchange if there is a charge-back or refund of a credit given in dollars for an item payable in a foreign currency. Compare Section 3-107(2). Fixing such a rule is desirable to avoid disputes. If in any case the parties wish to fix a different time for determining the rate of exchange, they may do so by agreement.

#### Cross references:

Sections 1-203, 3-107, 4-103, 4-211(3), 4-213(2) and (3), 4-402.

#### Definitional cross references:

"Account". Section 4-104.

"Collecting bank". Section 4-105.

"Customer". Section 4-104.

"Depository bank". Section 4-105.

"Intermediary bank". Section 4-105.

"Item". Section 4-104.

"Midnight deadline". Section 4-104.

"Payor bank". Section 4-105.

"Send". Section 1-201.

"Settlement". Section 4-104.

"Suspension of payment". Section 4-104.

### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection permits a collecting bank under stated circumstances to charge back against its customer's account when the collecting bank is unable to receive a final settlement.

*Subsection (2):* This subsection is optional; and it would permit the use of direct return procedures. As direct return procedures are now used by many banks in North Carolina, it appears that this subsection should be adopted in North Carolina.

*Subsection (3):* This subsection covers

the right of charge-back by a depository-payor bank. Basically such right is governed by GS 25-4-301 to which incorporating reference is made.

*Subsection (4):* This subsection merely preserves other remedies of a bank against its customer or other party.

*Subsection (5):* This subsection states a technical rule on foreign currency.

There was little or no statutory law in North Carolina on the matters in this entire section.

**§ 25-4-213. Final payment of item by payor bank; when provisional debits and credits become final; when certain credits become available for withdrawal.**—(1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:

- (a) paid the item in cash; or
- (b) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or
- (c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or
- (d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

Upon a final payment under subparagraphs (b), (c) or (d) the payor bank shall be accountable for the amount of the item.

(2) If provisional settlement for an item between the presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.

(3) If a collecting bank receives a settlement for an item which is or becomes final (subsection (3) of § 25-4-211, subsection (2) of § 25-4-213) the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(4) Subject to any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in an account with its customer becomes available for withdrawal as of right

- (a) in any case where the bank has received a provisional settlement for the

item,—when such settlement becomes final and the bank has had a reasonable time to learn that the settlement is final;

(b) in any case where the bank is both a depository bank and a payor bank and the item is finally paid,—at the opening of the bank's second banking day following receipt of the item.

(5) A deposit of money in a bank is final when made but, subject to any right of the bank to apply the deposit to an obligation of the customer, the deposit becomes available for withdrawal as of right at the opening of the bank's next banking day following receipt of the deposit. (1899, c. 733, s. 137; Rev., s. 2287; C. S., s. 3119; 1949, c. 954; 1965, c. 700, s. 1.)

**Crediting Customer Is Final Payment.**—When a bank credits a depositor with the amount of a check drawn upon it by another customer, and there is no want of good faith on the part of the depositor, the act of crediting is equivalent to a payment in money, and the bank cannot recall

or repudiate the payment because later it is ascertained that the drawer was without funds to meet the check, though when the payment was made the officials labored under the mistake that there were funds sufficient. *Woodward v. Savings & Trust Co.*, 178 N.C. 184, 100 S.E. 304 (1919).

#### OFFICIAL COMMENT

**Prior uniform statutory provisions:** None; but see Section 11, American Bankers Association Bank Collection Code.

##### Purposes:

1. By the definition and use of the term "settle" (Section 4—104 (j)) this Article recognizes that various debits or credits, remittances, settlements or payments given for an item may be either provisional or final, that settlements sometimes are provisional and sometimes are final and sometimes are provisional for awhile but later become final. Subsection (1) of Section 4—213 defines when settlement for an item or other action with respect to it constitutes final payment.

Final payment of an item is important for a number of reasons. It is one of several factors determining the relative priorities between items and notices, stop-orders, legal process and set-offs (Section 4—303). It is the "end of the line" in the collection process and the "turn around" point commencing the return flow of proceeds. It is the point at which many provisional settlements become final. See Section 4—213(2). Final payment of an item by the payor bank fixes preferential rights under Section 4—214(1) and (2).

2. If an item being collected moves through several states, e. g., is deposited for collection in California, moves through two or three California banks to the Federal Reserve Bank of San Francisco, to the Federal Reserve Bank of Boston, to a payor bank in Maine, the collection process involves the eastward journey of the item from California to Maine and the westward journey of the proceeds from Maine to California. Subsection (1) adopts the basic policy that final payment occurs at some point in the processing of the

item by the payor bank. This policy recognizes that final payment does not take place, in such hypothetical case, on the journey of the item eastward. It also adopts the view that neither does final payment occur on the journey westward because what in fact is journeying westward are *proceeds* of the item. Because the true tests of final payment are the same in all cases and to avoid the confusion resulting from variable standards, the rule basing final payment exclusively on action of the payor bank is not affected by whether payment is made by a remittance draft or whether such draft is itself paid. Consequently, subsection (1) rejects those cases which base time of payment of the item in remittance cases on whether the remittance draft was *accepted* by the presenting bank; *Page v. Holmes-Darst Coal Co.*, 269 Mich. 159, 256 N.W. 840 (1934); *Tobiason v. First State Bank of Ashby*, 173 Minn. 533, 217 N.W. 934 (1928); *Bohlig v. First Nat. Bank in Wadena*, 233 Minn. 523, 48 N.W.2d 445 (1951); *Dewey v. Margolis & Brooks*, 195 N.C. 307, 142 S.E. 22 (1928); *Texas Electric Service Co. v. Clark*, 47 S.W.2d 483 (Tex.Civ.App. 1932); cf. *Ellis Way Drug Co. v. McLean*, 176 Miss. 830, 170 So. 288 (1936); 2 *Paton's Digest* 1332; or whether the remittance draft was itself *paid*; *Cleve v. Craven Chemical Co.*, 18 F.2d 711 (4th Cir. 1927); *Holdingford Milling Co. v. Hillman Farmers' Cooperative Creamery*, 181 Minn. 212, 231 N.W. 928 (1930); or upon an election of a collecting bank under Section 11 of the American Bankers Association Bank Collection Code; *United States Pipe & Foundry Co. v. City of Hornell*, 146 Misc. 812, 263 N.Y.S. 89



(1933); *Jones v. Board of Education*, 242 App.Div. 17, 272 N.Y.S. 5 (1934); *Matter of State Bank of Binghamton*, 156 Misc. 353, 281 N.Y.S. 706 (1935); cf. *Malcolm, Inc. v. Burlington City Loan & Trust Co.*, 115 N.J. Eq. 227, 170 A. 32 (1934). Of course, the time of payment of the remittance draft will be governed by subsection (1) but payment or nonpayment of the remittance draft will not change the time of payment of the original item.

3. In fixing the point of time within the payor bank when an item is finally paid, subsection (1) recognizes and is framed on the basis that in a payor bank an item goes through a series of processes before its handling is completed. The item is received first from the clearing house or over the counter or through the mail. When received over the counter, the bank may receipt for it in some way by making a notation in the customer's passbook or by receipting a duplicate deposit slip. After the initial receipt the item moves to the sorting and proving departments. When sorted and proved it may be photographed. Still later it moves to the bookkeeping department where it is examined for form and signature and compared against the ledger account of the customer to whom it is to be charged. If it is in good form and there are funds to cover it, it is posted to the drawer's account, either immediately or at a later time. If paid, it is so marked and filed with other items of the same customer. This process may take either a few hours or substantially all of the day of receipt and of the next banking day.

Within this period of processing by the payor bank subsection (1) first recognizes two types of overt external acts constituting final payment. Traditionally and under various decisions payment in cash of an item by a payor bank has been considered final payment. *Chambers v. Miller*, 13 C.B.N.S. 125 (Eng. 1862); *Fidelity & Casualty Co., of New York v. Planenscheck*, 200 Wis. 304, 309, 227 N.W. 387, 389, 71 A.L.R. 331 (1929); see *Bellevue Bank of Allen Kimberly & Co. v. Security Nat. Bank of Sioux City*, 168 Iowa 707, 712, 150 N.W. 1076, 1077 (1915); 1 *Paton's Digest* 1066. Subsection (1) (a) first recognizes and provides that payment of an item in cash by a payor bank is final payment.

4. Section 4—104(j) defines "settle" as meaning "to pay in cash, by clearing house settlement, in a charge or credit or by remittance, or otherwise as instructed. A settlement may be either provisional or final;" subsection (1) (b) of Section

4—213 provides that an item is finally paid by a payor bank when the bank has "settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement". Subsection (1) (b) provides in effect that if the payor bank finally settles for an item this constitutes final payment of the item. The subsection operates if nothing has occurred and no situation exists making the settlement provisional. If at the time of settlement the payor bank reserves a right to revoke the settlement, the settlement is provisional. In the alternative, if under statute, clearing house rule or agreement, a right of revocation of the settlement exists the settlement is provisional. Conversely, if there is an absence of a reservation of the right to revoke and also an absence of a right to revoke under statute, clearing house rule or agreement, the settlement is final and such final settlement constitutes final payment of the item.

A primary example of a statutory right on the part of the payor bank to revoke a settlement is the right to revoke conferred by Section 4—301. The underlying theory and reason for deferred posting statutes (Section 4—301) is to require a settlement on the date of receipt of an item but to keep that settlement provisional with the right to revoke prior to the midnight deadline. In any case where Section 4—301 is applicable, any settlement by the payor bank is provisional solely by virtue of the statute, subsection (1) (b) of Section 4—213 does not operate and such provisional settlement does not constitute final payment of the item.

A second important example of a right to revoke a settlement is that arising under clearing house rules. It is very common for clearing house rules to provide that items exchanged and settled for in a clearing, (e. g., before 10:00 a.m. on Monday) may be returned and the settlements revoked up to but not later than 2:00 p.m. on the same day (Monday) or under deferred posting at some hour on the next business day (e. g., 2:00 p.m. Tuesday). Under this type of rule the Monday morning settlement is provisional and being provisional does not constitute a final payment of the item.

An example of a reservation of a right to revoke a settlement is where the payor bank is also the depository bank and has signed a receipt or duplicate deposit ticket or has made an entry in a passbook acknowledging receipt for credit

to the account of A, of a check drawn on it by B. If the receipt, deposit ticket, passbook or other agreement with A is to the effect that any credit so entered is provisional and may be revoked pending the time required by the payor bank to process the item to determine if it is in good form and there are funds to cover it, such reservation or agreement keeps the receipt or credit provisional and avoids it being either final settlement or final payment.

In other ways the payor bank may keep settlements provisional: by general or special agreement with the presenting party or bank; by simple reservation at the time the settlement is made; or otherwise. Thus a payor bank (except in the case of statutory provisions) has control whether a settlement made by it is provisional or final, by participating in general agreements or clearing house rules or by special agreement or reservation. If it fails to keep a settlement provisional and if no applicable statute keeps the settlement provisional, its settlement is final and, unless the item had previously been paid by one of the other methods prescribed in subsection (1), such final settlement constitutes final payment. In this manner payor banks may without difficulty avoid the effect of such cases as: *Cohen v. First Nat. Bank of Nogales*, 22 Ariz. 394, 400, 198 P. 122, 124, 15 A.L.R. 701 (1921); *Briviesca v. Coronado*, 19 Cal.2d 244, 120 P.2d 649 (1941); *White Brokerage Co. v. Cooperman*, 207 Minn. 239, 290 N.W. 790 (1940); *Scotts Bluff County v. First Nat. Bank of Gering*, 115 Neb. 273, 212 N.W. 617 (1927); *Provident Savings Bank & Trust Co. v. Hildebrand*, 49 Ohio App. 207, 196 N.E. 790, 791 (1934); *Schaer v. First Nat. Bank of Brenham*, 132 Tex. 499, 124 S.W.2d 108 (1939) (bill of exchange); *Union State Bank of Lancaster v. Peoples State Bank of Lancaster*, 192 Wis. 28, 33, 211 N.W. 931, 933 (1927); 1 Paton's Digest 1067.

5. If a payor bank has not previously paid an item in cash or finally settled for it, certain internal acts or procedures will produce final payment of the item. Exclusive of the external acts of payment in cash or final settlement, the key point at which the decision of the bank to pay or dishonor is made is when the bookkeeper for the drawer's account determines or verifies that the check is in good form and that there are sufficient funds in the drawer's account to cover it. Previous steps in the processing of an item are preliminary to this vital step

and in no way indicate a decision to pay. However, a more tangible measuring point is desirable than a mere examination of the account of the person to be charged. The mechanical step that usually indicates that the examination has been completed and the decision to pay has been made is the posting of the item to the account to be charged. Therefore, subsection (1) (c) adopts as the third measuring point the completion of the process of posting. The phrase "completed the process of posting" is used rather than simple "posting" because under current machine operations posting is a process and something more than simply making entries on the customer's ledger. Subsection (1) follows fairly closely the New York statute, 37 McKinney's Consolidated Laws of New York, Negotiable Instruments, Art. 19-A, Sec. 350-b as amended by L.1950, C. 153, Sec. 1. However, subsections (1) (a) and (b) furnish more precise rules for determining "final settlement" by the payor bank than does the New York statute in using the term "irrevocable credit", the definition of which is not helpful.

6. Subsection (1) (d) covers the situation where the payor bank makes a provisional settlement for an item, which settlement becomes final at a later time by reason of the failure of the payor bank to revoke it in the time and manner permitted by statute, clearing house rule or agreement. An example of this type of situation is the clearing house settlement referred to in Comment 4. In the illustration there given if the time limit for the return of items received in the Monday morning clearing is 2:00 p.m. on Tuesday and the provisional settlement has not been revoked at that time in a manner permitted by the clearing house rules, the provisional settlement made on Monday morning becomes final at 2:00 p.m. on Tuesday. Subsection (1) (d) provides specifically that in this situation the item is finally paid at 2:00 p.m. Tuesday. If on the other hand a payor bank receives an item in the mail on Monday and makes some provisional settlement for the item on Monday, it has until midnight on Tuesday to return the item or give notice and revoke any settlement under Section 4—301. In this situation subsection (1) (d) of Section 4—213 provides that if the provisional settlement made on Monday is not revoked before midnight on Tuesday as permitted by Section 4—301, the item is finally paid at midnight on Tuesday even if the process of posting the item to the account



of the drawer has not been completed at that time.

7. Subsection (1) provides that an item is finally paid by the payor bank when any one of the four events set forth in subparagraphs (a), (b), (c) and (d) have occurred, whichever happens first, and then provides that upon a final payment under subparagraphs (b), (c) or (d) the payor bank shall be accountable for the amount of the item. It is not made accountable if it has paid the item in cash because such payment is itself a sufficient accounting. The term "accountable" is used as imposing a duty to account, which duty is met if and when a settlement for the item satisfactorily clears. The fact that determination of the time of final payment is based exclusively upon action of the payor bank is not detrimental to the interests of owners of items or collecting banks because of the general obligations of payors to honor or dishonor and the time limits for action imposed by Sections 4-301 and 4-302.

8. Subsection (2) states the country-wide usage that when the item is finally paid by the payor bank under subsection (1) this final payment automatically without further action "firms up" other provisional settlements made for it. However, this subsection makes clear that this "firming up" occurs only where the settlement between the presenting and payor banks was made either through a clearing house or by debits and credits in accounts between them. It does not take place where the payor bank remits for the item with some form of remittance instrument. Further, the "firming up" continues only to the extent that provisional debits and credits are entered seriatim in accounts between banks which are successive to the presenting bank. The automatic "firming up" is broken at any time that any collecting bank remits for the item with a remittance draft, because final payment to the remittee then usually depends upon final payment of the remittance draft.

9. Subsection (3) states the general rule that if a collecting bank receives settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item. One means of accounting is to remit to its customer the amount it has received on the item. If previously it gave to its customer a provisional credit for the item in an account its receipt of final settlement for the item "firms up" this provisional credit and makes it final. When

this credit given by it so becomes final, in the usual case its agency status terminates and it becomes a debtor to its customer for the amount of the item. See Section 4-201(1). If the accounting is by a remittance instrument or authorization to charge further time will usually be required to complete its accounting (Section 4-211).

10. Subsection (4) states when certain credits given by a bank to its customer become available for withdrawal as of right. Subsection (4) (a) deals with the situation where a bank has given a credit (usually provisional) for an item to its customer and in turn has received a provisional settlement for the item from an intermediary or payor bank to which it has forwarded the item. In this situation before the provisional credit entered by the collecting bank in the account of its customer becomes available for withdrawal as of right, it is not only necessary that the provisional settlement received by the bank for the item becomes final but also that the collecting bank has a reasonable time to learn that this is so. Hence, subsection (4) (a) imposes both of these conditions. If the provisional settlement received is a provisional debit or credit in an account with the intermediary or payor bank or a remittance instrument on some bank other than the collecting bank itself, the collecting bank will usually learn that this debit or credit is final or that the remittance instrument has been paid merely by not learning the opposite within a reasonable time. How much time is "reasonable" for these purposes will of course depend on the distance the item has to travel and the number of banks through which it must pass (having in mind not only travel time by regular lines of transmission but also the successive midnight deadlines of the several banks) and other pertinent facts. Also, if the provisional settlement received is some form of a remittance instrument or authorization to charge, the "reasonable" time depends on the identity and location of the payor of the remittance instrument, the means for clearing such instrument and other pertinent facts.

11. Subsection (4) (b) deals with the situation of a bank which is both a depository bank and a payor bank. The subsection recognizes that where A and B are both customers of a depository-payor bank and A deposits B's check on the depository-payor in A's account on Monday, time must be allowed to per-



mit the check under the deferred posting rules of Section 4—301 to reach the bookkeeper for B's account at some time on Tuesday, and if there are insufficient funds in B's account to reverse or charge back the provisional credit in A's account. Consequently this provisional credit in A's account does not become available for withdrawal as of right until the opening of business on Wednesday. If it is determined on Tuesday that there are insufficient funds in B's account to pay the check the credit to A's account can be reversed on Tuesday. On the other hand if the item is in fact paid on Tuesday, the rule of subsection (4) (b) is desirable to avoid uncertainty and possible disputes between the bank and its customer as to exactly what hour within the day the credit is available.

12. Subsection (5) recognizes that even when A makes a deposit of cash in his account on Monday it takes some period of time to record that cash deposit and communicate it to A's bookkeeper (the bookkeeper handling A's account) so that A's bookkeeper has a record of it when she considers whether there are available funds to pay A's check. Where as indicated in Comment 5 A's bookkeeper is

the particular employee in the bank to determine, in most cases and subject to supervisory control, whether the item may be paid, the effectiveness of a deposit of cash as a basis for paying a check must of necessity rest upon when the record of that deposit reaches such bookkeeper rather than when it passes through the teller's window. Consequently, although the bank is charged with responsibility for cash deposited from the moment it is received on Monday the cash is not effective as a basis for paying checks until the opening of business on Tuesday.

#### Cross references:

Sections 3—418, 4—107, 4—201, 4—211, 4—212, 4—214, 4—301, 4—302, 4—303.

#### Definitional cross references:

"Account". Section 4—104.

"Agreement". Section 1—201.

"Banking day". Section 4—104.

"Clearing house". Section 4—104.

"Collecting bank". Section 4—105.

"Customer". Section 4—104.

"Depository bank". Section 4—105.

"Item". Section 4—104.

"Money". Section 1—201.

"Notice". Section 1—201.

"Payor bank". Section 4—105.

"Presenting bank". Section 4—105.

"Settlement". Section 4—104.

### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection states the several times at which a payment by a payor bank becomes final. This affects the discharge of the *drawer* and indorsers, as well as the rights of other parties in the collection chain.

The time of final payment is important for several reasons:

(1) It is a factor relative to priorities between items and notices, stop-orders, legal process and set-offs (GS 25-4-303).

(2) It is the "end of the line" in the collecting process and the turn around point commencing the return flow of proceeds.

(3) It is the point at which many provisional settlements become final (see GS 25-4-213 (2)).

(4) Final payment of an item by the payor fixes preferences under GS 25-4-214 (1) and (2).

Aside from GS 25-144, which contained a provision on "midnight deadline," there was little or no statutory law in North Carolina on this matter.

A long Official Comment explains this section, and a nutshell summary is not suitable here. However, Official Comment 2 notes that subsection (1) adopts the policy that final payment occurs at some point in the processing of the item by the *payor* bank. Thus, it rejects cases holding final payment is influenced by: (1) Whether a remittance draft was *accepted* by the presenting bank: *Dewey Bros. v. Margolis & Brooks*, 195 N.C. 307, 142 S.E. 22 (1928); or (2) whether the remittance draft itself was *paid*: *Cleve v. Craven Chem. Co.*, 18 F.2d 711 (4th Cir. 1927).

**§ 25-4-214. Insolvency and preference.**—(1) Any item in or coming into the possession of a payor or collecting bank which suspends payment and which item is not finally paid shall be returned by the receiver, trustee or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(2) If a payor bank finally pays an item and suspends payments without making a settlement for the item with its customer or the presenting bank which settlement is or becomes final, the owner of the item has a preferred claim against the payor bank.

(3) If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent or interfere with the settlement becoming final if such finality occurs automatically upon the lapse of certain time or the happening of certain events (subsection (3) of § 25-4-211, subsections (1) (d), (2) and (3) of § 25-4-213).

(4) If a collecting bank receives from subsequent parties settlement for an item which settlement is or becomes final and suspends payments without making a settlement for the item with its customer which is or becomes final, the owner of the item has a preferred claim against such collecting bank. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see Section 13, American Bankers Association Bank Collection Code.

**Purposes:**

1. The underlying purpose of the provisions of this section is not to confer upon banks, holders of items or anyone else preferential positions in the event of bank failures over general depositors or any other creditors of the failed banks. The purpose is to fix as definitely as possible the cut-off point of time for the completion or cessation of the collection process in the case of items that happen to be in such process at the time a particular bank suspends payments. It must be remembered that in bank collections as a whole and in the handling of items by an individual bank, items go through a whole series of processes. It must also be remembered that at any particular point of time a particular bank (at least one of any size) is functioning as a depository bank for some items, as an intermediary bank for others, as a presenting bank for still others and as a payor bank for still others, and that when it suspends payments it will have close to its normal load of items working through its various processes. For the convenience of receivers, owners of items, banks, and in fact substantially everyone concerned, it is recognized that at the particular moment of time that a bank suspends payment, a certain portion of the items being handled by it have progressed far enough in the bank collection process that it is preferable to permit them to continue the remaining distance, rather than to send them back and reverse the many entries that have been made or

the steps that have been taken with respect to them. Therefore, having this background and these purposes in mind, the section states what items must be turned backward at the moment suspension intervenes and what items have progressed far enough that the collection process with respect to them continues, with the resulting necessary statement of rights of various parties flowing from this prescription of the cut-off time.

2. The rules stated are similar to those stated in the American Bankers Association Bank Collection Code, but with the abandonment of any theory of trust. Although for practical purposes Federal Deposit Insurance affects materially the result of bank failures on holders of items and banks, no attempt is made to vary the rules of the section by reason of such insurance.

3. It is recognized that in view of *Jennings v. United States Fidelity & Guaranty Co.*, 294 U.S. 216, 55 S.Ct. 394, 79 L.Ed. 869, 99 A.L.R. 1248 (1935), amendment of the National Bank Act would be necessary to have this section apply to national banks. But there is no reason why it should not apply to others. See Section 1-108.

**Cross references:**

Sections 1-108, 4-211(3) and 4-213.

**Definitional cross references:**

"Collecting bank". Section 4-105.

"Customer". Section 4-104.

"Item". Section 4-104.

"Payor bank". Section 4-105.

"Presenting bank". Section 4-105.

"Settlement". Section 4-104.

"Suspends payment". Section 4-104.

#### NORTH CAROLINA COMMENT

A careful study should be made of this section and GS 53-20 (m) to determine whether GS 53-20 (m) should be modified to conform to this section.

This section does not apply to national banks.

## PART 3.

## COLLECTION OF ITEMS: PAYOR BANKS.

**§ 25-4-301. Deferred posting; recovery of payment by return of items; time of dishonor.**—(1) Where an authorized settlement for a demand item (other than a documentary draft) received by a payor bank otherwise than for immediate payment over the counter has been made before midnight of the banking day of receipt the payor bank may revoke the settlement and recover any payment if before it has made final payment (subsection (1) of § 25-4-213) and before its midnight deadline it

(a) returns the item; or

(b) sends written notice of dishonor or nonpayment if the item is held for protest or is otherwise unavailable for return.

(2) If a demand item is received by a payor bank for credit on its books it may return such item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in the preceding subsection.

(3) Unless previous notice of dishonor has been sent an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(4) An item is returned:

(a) as to an item received through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with its rules; or

(b) in all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to his instructions. (1899, c. 733, s. 137; Rev., s. 2287; C. S., s. 3119; 1949, c. 954; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see American Bankers Association Model Deferred Posting Statute.

**Purposes:**

1. Deferred posting and delayed returns is that practice whereby a payor bank sorts and proves items received by it on the day they are received, e. g. Monday, but does not post the items to the customer's account or return "not good" items until the next day, e. g. Tuesday. The practice typifies "production line" methods currently used in bank collection and is based upon the necessity of an even flow of items through payor banks on a day by day basis in a manner which can be handled evenly by employee personnel without abnormal peak load periods, night work, and other practices objectionable to personnel. Since World War II statutes authorizing deferred posting and delayed returns have been passed in almost all of the forty-eight states. This section codifies the content of these statutes and approves the practice.

2. The time limits for action imposed by subsection (1) are adopted by subsection (2) for cases where the payor bank is also the depositary bank, but in

this case the requirement of a settlement on the day of receipt is omitted.

3. Subsection (3) fixes a base point from which to measure the time within which notice of dishonor must be given. See Section 3—508.

4. Subsection (4) leaves banks free to agree upon the manner or returning items but establishes a precise time when an item is "returned". For definition of "sent" as used in subsections (a) and (b) see Section 1—201(38).

5. Obviously the section assumes that the item has not been "finally paid" under Section 4—213(1). If it has been, this section has no operation.

**Cross references:**

Sections 3—508, 4—213, 4—302.

**Definitional cross references:**

"Banking day". Section 4—104.

"Clearing house". Section 4—104.

"Collecting bank". Section 4—105.

"Customer". Section 4—104.

"Documentary draft". Section 4—104.

"Item". Section 4—104.

"Midnight deadline". Section 4—104.

"Notice of dishonor". Section 3—508.

"Payor bank". Section 4—105.

"Presenting bank". Section 4—105.

"Sent". Section 1—201(38).

"Settlement". Section 4—104.



## NORTH CAROLINA COMMENT

The only known statute in North Carolina relating to the several subjects of this section was GS 25-144, which had some bearing on deferred posting.

"Midnight deadline" is defined in GS 25-4-104.

*Subsection (1):* This subsection states the general rule that lets a payor bank which makes a settlement of a demand item on the day the item was received to

*revoke* the settlement by its midnight deadline.

*Subsection (2):* This subsection applies the same rule to a payor-depositary bank, except it omits the requirement of a settlement on the day of receipt.

This section must be read in conjunction with GS 25-4-302, which states the consequences of a late return.

**§ 25-4-302. Payor bank's responsibility for late return of item.**—In the absence of a valid defense such as breach of a presentment warranty (subsection (1) of § 25-4-207), settlement effected or the like, if an item is presented on and received by a payor bank the bank is accountable for the amount of

(a) a demand item other than a documentary draft whether properly payable or not if the bank, in any case where it is not also the depository bank, retains the item beyond midnight of the banking day of receipt without settling for it or, regardless of whether it is also the depository bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or

(b) any other properly payable item unless within the time allowed for acceptance or payment of that item the bank either accepts or pays the item or returns it and accompanying documents. (1899, c. 733, s. 137; Rev., s. 2287; C. S., s. 3119; 1949, c. 954; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None; but see American Bankers Association Model Deferred Posting Statute.

**Purposes:**

Under Section 4-301, time limits are prescribed within which a payor bank must take action if it receives an item payable by it. Section 4-302 states the rights of the customer if the payor bank fails to take the action required within the time limits prescribed.

**Cross reference:**

Section 4-301.

**Definitional cross references:**

"Acceptance". Section 3-410.

"Banking day". Section 4-104.

"Customer". Section 4-104.

"Depository bank". Section 4-105.

"Documentary draft". Section 4-104.

"Item". Section 4-104.

"Midnight deadline". Section 4-104.

"Notice of dishonor". Section 3-508.

"Payor bank". Section 4-105.

"Properly payable". Section 4-104.

"Settle". Section 4-104.

## NORTH CAROLINA COMMENT

*Subsection (a):* This subsection prescribes the time in which a payor bank must act on a demand item other than a documentary draft.

*Subsection (b):* This covers all other items.

In either case, if the payor bank does not act promptly it is accountable for the amount of the item. Compare *Branch Bank & Trust Co. v. Bank of Washington*, 255 N.C. 205, 120 S.E.2d 830 (1961), dealing with duty of a collecting bank that is not a payor bank. Held—The payor's bank is not liable as a constructive acceptor when it delays returning a draft; but court implies on p. 222 that bank might be liable for negligence. The two dissenting justices would adhere to the "time honored maxim

among bankers . . . 'Never let the sun set on a Cash Item.'"

For demand items other than documentary drafts, a comparison of this section with GS 25-4-301 shows that:

(1) GS 25-4-301 (1) and (2) emphasize the time for *revocation* of prompt settlement made by midnight of the day of receipt.

(2) GS 25-4-302 (b) emphasizes *promptness in making an original settlement on the day of receipt* even though the prompt settlement may be later revoked by the "midnight deadline."

Thus, it appears that under both GS 25-4-301 (1) and 25-4-302 (b), a bank is liable for failure to "settle" for an item by midnight of the day it is received. This

provision helps to minimize the "float period" by demanding "day received settlement," but then the deferred posting

relief of GS 25-4-301 steps in to give until the "midnight deadline" to *revoke* a previous conditional settlement.

**§ 25-4-303. When items subject to notice, stop-order, legal process or setoff; order in which items may be charged or certified.**—(1) Any knowledge, notice or stop-order received by, legal process served upon or setoff exercised by a payor bank, whether or not effective under other rules of law to terminate, suspend or modify the bank's right or duty to pay an item or to charge its customer's account for the item, comes too late to so terminate, suspend or modify such right or duty if the knowledge, notice, stop-order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the bank has done any of the following :

- (a) accepted or certified the item ;
- (b) paid the item in cash ;
- (c) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement ;
- (d) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item ; or
- (e) become accountable for the amount of the item under subsection (1) (d) of §§ 25-4-213 and 25-4-302 dealing with the payor bank's responsibility for late return of items.

(2) Subject to the provisions of subsection (1) items may be accepted, paid, certified or charged to the indicated account of its customer in any order convenient to the bank. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. The comments to Section 4—213 describe the process through which an item passes in the payor bank. Prior to this process or at any time while it is going on, the payor bank may receive knowledge or a legal notice affecting the item, such as knowledge or a notice that the drawer has filed a petition in bankruptcy or made an assignment for the benefit of creditors; may receive an order of the drawer stopping payment on the item; may have served on it an attachment of the account of the drawer; or the bank itself may exercise a right of setoff against the drawer's account. Each of these events affects the account of the drawer and may eliminate or freeze all or part of whatever balance is available to pay the item. Subsection (1) states the rule for determining the relative priorities between these various legal events and the item.

2. The rule is that if any one of several things has been done to the item or if it has reached any one of several stages in its processing at the time the knowledge, notice, stop-order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised, the

knowledge, notice, stop-order, legal process or setoff comes too late, the item has priority and a charge to the customer's account may be made and is effective. Certain of the tests determining the priority status of the item are the same as for final payment under Section 4—213(1), but additional tests apply in the context of the present section. The first event mentioned, namely, acceptance, means formal acceptance as that term is used and defined in Section 3—410. Certification is the type of certification defined in Section 3—411. Payment of the item in cash under Section 4—213(1) (a), final settlement for the item under Section 4—213(1) (b) and completion of the process of posting under Section 4—213(1) (c) all constitute final payment of the item and confer priority. After a cash payment, final settlement or the completion of the process of posting, any knowledge, notice, stop-order, legal process or setoff comes too late and cannot interfere with either the payment of the item or a charge to the customer's account based upon such payment.

3. The sixth event conferring priority is stated by the language "or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item." This general

"omnibus" language is necessary to pick up other possible types of action impossible to specify particularly but where the bank has examined the account to see if there are sufficient funds and has taken some action indicating an intention to pay. An example is what has sometimes been called "sight posting" where the bookkeeper examines the account and makes a decision to pay but postpones posting. The clause should be interpreted in the light of *Nineteenth Ward Bank v. First Nat. Bank of South Weymouth*, 184 Mass. 49, 67 N.E. 670 (1903). It is not intended to refer to various preliminary acts in no way close to a true decision of the bank to pay the item, such as receipt of the item over the counter for deposit, entry of a provisional credit in a passbook, or the making of a provisional settlement for the item through the clearing house, by entries in accounts, remittance or otherwise. All actions of this type are provisional and none of them evidences the bank's decision to pay the item. In this section as in Section 4-213 reasoning such as appears in *Cohen v. First Nat. Bank of Nogales*, 22 Ariz. 394, 400, 198 P. 122, 124, 15 A.L.R. 701 (1921); *Briviesca v. Coronado*, 19 Cal.2d 244, 120 P.2d 649 (1941); *White Brokerage Co. v. Cooperman*, 207 Minn. 239, 290 N.W. 790 (1940); *Scotts Bluff County v. First Nat. Bank of Gering*, 115 Neb. 273, 212 N.W. 617, 618 (1927); *Provident Savings Bank & Trust Co. v. Hildebrand*, 49 Ohio App. 207, 196 N.E. 790, 791 (1934); *Schaer v. First Nat. Bank of Brenham*, 132 Tex. 499, 124 S.W.2d 108 (1939) (bill of exchange); *Union State Bank of Lancaster v. People's State Bank of Lancaster*, 192 Wis. 28, 33, 211 N.W. 931, 933 (1927); 1 *Paton's Digest* 1067, is rejected.

4. The seventh and last event conferring priority for an item and a charge to the customer's account based upon the item is stated by the language "become accountable for the amount of the item under subsection (1) (d) of Section 4-213 and Section 4-302 dealing with the payor bank's responsibility for late return of items". Under Section 4-213(1) (d) if a payor bank makes a provisional settlement for an item and fails to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement, such combination of events constitutes final payment of the item. Under Section 4-302 a payor bank may also become accountable for the amount of an item in certain other situations even though there has been no provi-

sional settlement for the item or such action as constitutes final payment under Section 4-213(1). Expiration of the deadlines under Section 4-213(1) (d) or 4-302 with resulting accountability by the payor bank for the amount of the item, establishes priority of the item over notices, stop-orders, legal process or setoff.

5. In the case of knowledge, notice, stop-orders and legal process the effective time for determining whether they were received too late to affect the payment of an item and a charge to the customer's account by reason of such payment, is receipt plus a reasonable time for the bank to act on any of these communications. Usually a relatively short time is required to communicate to the bookkeeping department advice of one of these events but certainly some time is necessary. Compare Sections 1-201(27) and 4-403. In the case of setoff the effective time is when the setoff is actually made.

6. As between one item and another no priority rule is stated, other than the convenience of the bank. This rule is justified because of the impossibility of stating a rule that would be fair in all cases, having in mind the almost infinite number of combinations of large and small checks in relation to the available balance on hand in the drawer's account; the possible methods of receipt; and other difficulties. Further, where the drawer has drawn all the checks, he should have funds available to meet all of them and has no basis for urging one should be paid before another; and the holders have no direct right against the payor bank in any event, unless of course, the bank has accepted, certified or finally paid a particular item, or has become liable for it under Section 4-302. Under subsection (2) the bank obviously has the right to pay items for which it is itself liable ahead of those for which it is not.

#### Cross references:

Sections 3-410, 3-411, 4-213(1), 4-301, 4-302.

#### Definitional cross references:

"Accepted". Section 3-410.  
 "Account". Section 4-104.  
 "Agreement". Section 1-201.  
 "Certified". Section 3-411.  
 "Clearing house". Section 4-104.  
 "Customer". Section 4-104.  
 "Item". Section 4-104.  
 "Notice". Section 1-201.  
 "Payor bank". Section 4-105.  
 "Settle". Section 4-104.



## NORTH CAROLINA COMMENT

*Subsection (1):* This subsection indirectly gives a payor bank a reasonable time to act on any notice it receives. However, the main emphasis is on establishing a cut-off time for determining the bank's

right or duty to pay an item or to charge the customer's account for the item.

See also GS 25-4-403 (customer's right to stop payment; burden of proof of loss).

## PART 4.

## RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER.

§ 25-4-401. **When bank may charge customer's account.**—(1) As against its customer, a bank may charge against his account any item which is otherwise properly payable from that account even though the charge creates an overdraft.

(2) A bank which in good faith makes payment to a holder may charge the indicated account of its customer according to

(a) the original tenor of his altered item; or

(b) the tenor of his completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. It is fundamental that upon proper payment of a draft the drawee may charge the account of the drawer. This is true even though the draft is an overdraft since the draft itself authorizes the payment for the drawer's account and carries an implied promise to reimburse the drawee.

2. Subsection (2) parallels the provision which protects a holder in due course against discharge by reason of alteration and permits him to enforce the instrument according to its original tenor. Section 3-407(3). It adopts the rule of cases extending the same protection to a drawee

who pays in good faith. The subsection also follows the policy of Sections 3-115 and 3-407(3) by protecting the drawee who pays a completed instrument in good faith according to the instrument as completed.

**Cross references:**

Sections 3-115 and 3-407.

**Definitional cross references:**

"Account". Section 4-104.

"Bank". Section 1-201.

"Customer". Section 4-104.

"Good faith". Section 1-201.

"Holder". Section 1-201.

"Item". Section 4-104.

"Properly payable". Section 4-104.

## NORTH CAROLINA COMMENT

*Subsection (1):* This subsection expressly permits overdrafts; but a bank is *not required* to pay overdraft items.

*Subsection (2):* This covers the amounts that may be properly charged against a customer's account. The two provisions follow the same theories found in: (a) GS 25-3-407 (3), which permits an HDC to collect the original tenor of an altered

negotiable instrument; (b) GS 25-3-115 and 25-3-407 (3), which permit full recovery on incomplete instruments completed in excess of authority.

This section is broader in scope than the article 3 sections, because article 3 applies only to "negotiable instruments," while this section applies to any "item."

§ 25-4-402. **Bank's liability to customer for wrongful dishonor.**—A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. When the dishonor occurs through mistake liability is limited to actual damages proved. If so proximately caused and proved damages may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case. (1921, c. 4, s. 38; C. S., s. 220(m); 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

Prior uniform statutory provision: None.

**Purposes:**

1. This section is new to the Uniform Laws, although similar statutory provisions are in existence in twenty-three jurisdictions.

2. The liability of the drawee for dishonor has sometimes been stated as one for breach of contract, sometimes as for negligence or other breach of a tort duty, and sometimes as for defamation. This section does not attempt to specify a theory. "Wrongful dishonor" excludes any permitted or justified dishonor, as where the drawer has no credit extended by the drawee, or where the draft lacks a necessary indorsement or is not properly presented.

3. This section rejects decisions which have held that where the dishonored item has been drawn by a merchant, trader or fiduciary he is defamed in his business, trade or profession by a reflection on his credit and hence that substantial damages

may be awarded on the basis of defamation "per se" without proof that damage has occurred. The merchant, trader and fiduciary are placed on the same footing as any other drawer and in all cases of dishonor by mistake damages recoverable are limited to those actually proved.

4. Wrongful dishonor is different from "failure to exercise ordinary care in handling an item", and the measure of damages is that stated in this section, not that stated in Section 4—103(5).

5. The fourth sentence of the section rejects decisions holding that as a matter of law the dishonor of a check is not the "proximate cause" of the arrest and prosecution of the customer, and leaves to determination in each case as a question of fact whether the dishonor is or may be the "proximate cause".

**Definitional cross references:**

"Bank". Section 1—201.

"Customer". Section 4—104.

"Item". Section 4—104.

**NORTH CAROLINA COMMENT**

This section states the measure of damages for wrongful dishonor of an item. It appears that it does not change the substance of GS 53-57. There were only two North Carolina decisions on GS 53-57:

Thomas v. American Trust Co., 208 N.C. 653, 182 S.E. 136 (1935), held, when no malice in dishonor, the customer is entitled at least to nominal damages. This

dictum (?) seems contrary to the wording of GS 53-57 and 25-4-402, both of which adopt an "actual damages proved" test when no malice is proved.

Woody v. First Nat'l Bank, 194 N.C. 549, 140 S.E. 150 (1927), held, if malice is proved, the depositor can recover actual or nominal damages, and also punitive damages.

**§ 25-4-403. Customer's right to stop payment; burden of proof of loss.**—(1) A customer may by order to his bank stop payment of any item payable for his account but the order must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it prior to any action by the bank with respect to the item described in § 25-4-303.

(2) An oral order is binding upon the bank only for fourteen calendar days unless confirmed in writing within that period. A written order is effective for only six months unless renewed in writing.

(3) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a binding stop payment order is on the customer. (1929, c. 341, s. 1; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

Prior uniform statutory provision: None.

**Purposes:**

1. This section is new. It is intended to replace separate statutes in twenty-nine states which regulate stop-payment orders.

2. The position taken by this section is that stopping payment is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense. The inevitable occasional losses through failure

to stop should be borne by the banks as a cost of the business of banking.

3. Subsection (1) follows the decisions holding that a payee or indorsee has no right to stop payment. This is consistent with the provision governing payment or satisfaction. See Section 3—603. The sole exception to this rule is found in Section 4—405 on payment after notice of death, by which any person claiming an interest in the account can stop payment.

4. Payment is commonly stopped only on checks; but the right to stop payment is not limited to checks, and extends to any item payable by any bank. Where the maker of a note payable at a bank is in a position analogous to that of a drawer (Section 3—121) he may stop payment of the note. By analogy the rule extends to drawees other than banks.

5. There is no right to stop payment after certification of a check or other acceptance of a draft, and this is true no matter who procures the certification. See Sections 3—411 and 4—303. The acceptance is the drawee's own engagement to pay, and he is not required to impair his credit by refusing payment for the convenience of the drawer.

6. Normally a direction to stop payment is first given by telephone. Notwithstanding statutes which require a written order, banks customarily accept such directions, and have been held to waive the writing. Subsection (2) is intended to protect both parties by making the oral direction effective for only a short time during which the drawer must confirm it in writing, and by eliminating thereafter any claim of waiver by acceptance of the oral direction.

7. The existing statutes all specify a time limit after which any direction to stop payment becomes ineffective unless it is renewed in writing; and the majority of them have specified six months. The purpose of the provision is, of course, to facilitate stopping payment by clearing the records of the drawee of accumulated unrevoked stop orders, as where the drawer has found a lost instrument or has settled his controversy with the payee, but has failed to notify the drawee. The last sentence of subsection (2), together with the second clause in Section 4—404, rejects the reasoning of such cases as *Goldberg v. Manufacturers Trust Company*, 199 Misc. 167, 102 N.Y.S.2d 144 (1951).

8. A payment in violation of an effective direction to stop payment is an improper payment, even though it is made by mistake or inadvertence. Any agreement to the contrary is invalid under Section 4—103(1) if in paying the item over the stop payment order the bank has failed to exercise ordinary care. The drawee is, however, entitled to subrogation to prevent unjust enrichment (Section 4—407); retains common-law defenses, e. g., that by conduct in recognizing the payment the customer has ratified the bank's action in paying over a stop payment order (Section 1—103); and retains common-law rights, e. g., to recover money paid under a mistake (Section 1—103) in cases where the payment is not made final by Section 3—418. It has sometimes been said that payment cannot be stopped against a holder in due course, but the statement is inaccurate. The payment can be stopped but the drawer remains liable on the instrument to the holder in due course (Sections 3—305, 3—413) and the drawee, if he pays, becomes subrogated to the rights of the holder in due course against the drawer. Section 4—407. Any defenses available against a holder in due course remain available to the drawer, but other defenses are cut off to the same extent as if the holder himself were bringing the action.

#### Cross references:

Point 3: Sections 3—603(1), 4—405.

Point 4: Section 3—121.

Point 5: Sections 3—411 and 4—303.

Point 8: Sections 3—305, 3—413, 3—418, 4—103 and 4—407.

#### Definitional cross references:

"Account". Section 4—104.

"Bank". Section 1—201.

"Burden of establishing". Section 1—201.

"Customer". Section 4—104.

"Item". Section 4—104.

"Send". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection gives a bank a reasonable time to act on a stop-order.

*Subsection (2):* This subsection makes an oral stop-order effective for fourteen days and a written stop-order effective for six months. This differs from GS 25-198 which (a) implied that an original oral stop-order was effective for six months and (b) stated that a renewal stop-order had to be in writing and was effective for six months.

Payment may not be stopped after acceptance of a draft or certification of a check. See GS 25-3-411 and 25-4-303.

*Subsection (3):* Payment in violation of

a stop-order is improper, but under subsection (3) the customer must prove his damages.

While a bank may contract to relieve itself of liability for nonnegligently overlooking a stop-order, it may not contract away its duty to use reasonable care. Also, to prevent unjust enrichment, a bank is given subrogation rights under GS 25-4-407.

(*Note:* The section applies only to bank-drawees, but it applies to any "item." Article 3 contains no similar rule for "negotiable instruments" drawn on nonbanks, but the same right to stop payment exists apart from statute.)



**§ 25-4-404. Bank not obligated to pay check more than six months old.**—A bank is under no obligation to a customer having a checking account to pay a check, other than a certified check, which is presented more than six months after its date, but it may charge its customer's account for a payment made thereafter in good faith. (C. S., s. 3168; 1929, c. 341, s. 3; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

This section incorporates a type of statute adopted in twenty-six jurisdictions. The time limit is set at six months because banking and commercial practice regards a check outstanding for longer than that period as stale, and a bank will normally not pay such a check without consulting the depositor. It is therefore not required to do so, but is given the option to pay because it may be in a position to know, as in the case of dividend checks, that the drawer wants payment made.

Certified checks are excluded from the

section because they are the primary obligation of the certifying bank (Sections 3—411 and 3—413), which obligation runs direct to the holder of the check. The customer's account was charged when the check was certified.

**Cross references:**

Sections 3—411 and 3—413.

**Definitional cross references:**

"Account". Section 4—104.

"Bank". Section 1—201.

"Check". Section 3—104.

"Customer". Section 4—104.

"Good faith". Section 1—201.

"Present". Section 3—504.

#### NORTH CAROLINA COMMENT

This section is similar to GS 25-194, a section added by North Carolina to the NIL. GS 25-194, however, was broader than this UCC section in that GS 25-194

applied to "a check or other instrument payable on demand." GS 25-4-404 applies only to checks.

**§ 25-4-405. Death or incompetence of customer.**—(1) A payor or collecting bank's authority to accept, pay or collect an item or to account for proceeds of its collection if otherwise effective is not rendered ineffective by incompetence of a customer or [of] either bank existing at the time the item is issued or its collection is undertaken if the bank does not know of an adjudication of incompetence. Neither death nor incompetence of a customer revokes such authority to accept, pay, collect or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it.

(2) Even with knowledge a bank may for ten days after the date of death pay or certify checks drawn on or prior to that date unless ordered to stop payment by a person claiming an interest in the account. (1965, c. 700, s. 1.)

**Editor's Note.**—The "of" in brackets is suggested as a correction of "or," which appears in the 1965 Session Laws.

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. This section is new, although similar statutory provisions are in existence in seven states.

2. Subsection (1) follows existing decisions which hold that a drawee (payor) bank is not liable for the payment of a check before it has notice of the death or incompetence of the drawer. The justice and necessity of the rule are obvious. A check is an order to pay which the bank must obey under penalty of possible liability for dishonor. Further, with the tremendous volume of items handled any

rule which required banks to verify the continued life and competency of drawers would be completely unworkable.

One or both of these same reasons apply to other phases of the bank collection and payment process and the rule is made wide enough to apply to these other phases. It applies to all kinds of "items", to "customers" who own items as well as "customers" who draw or make them; to the function of collecting items as well as the function of accepting or paying them; to the carrying out of instructions to account for proceeds even though these may involve transfers to third parties; to deposi-

tary and intermediary banks as well as payor banks; and to incompetency existing at the time of the issuance of an item or the commencement of the collection or payment process as well as to incompetency occurring thereafter. Further, the requirement of actual knowledge makes inapplicable the rule of some cases that an adjudication of incompetency is constructive notice to all the world because obviously it is as impossible for banks to keep posted on such adjudications (in the absence of actual knowledge) as it is to keep posted as to death of immediate or remote customers.

3. Subsection (2) provides a limited period after death during which a bank may continue to pay checks (as distinguished from other items) even though it has notice. The purpose of the provision, as of the existing statutes, is to permit holders of checks drawn and issued shortly before death to cash them without the necessity of filing a claim in probate. The justification is that such checks normally are given in immediate payment of an obligation, that there is almost never any reason why they should not be paid, and that filing in probate is a useless formality, burdensome to the holder, the executor, the court and the bank.

This section does not prevent an executor or administrator from recovering the payment from the holder of the check. It is not intended to affect the validity of any gift causa mortis or other transfer in contemplation of death, but, merely to relieve the bank of liability for the payment.

4. Any surviving relative, creditor or other person who claims an interest in the account may give a direction to the bank not to pay checks, or not to pay a particular check. Such notice has the same effect as a direction to stop payment. The bank has no responsibility to determine the validity of the claim or even whether it is "colorable". But obviously anyone who has an interest in the estate, including the person named as executor in a will, even if the will has not yet been admitted to probate, is entitled to claim an interest in the account.

#### Definitional cross references:

"Accept". Section 3—410.

"Bank". Section 1—201.

"Certify". Section 3—411.

"Check". Section 3—104.

"Customer". Section 4—104.

"Depository bank". Section 4—105.

"Item". Section 4—104.

"Payor bank". Section 4—105.

### NORTH CAROLINA COMMENT

Banking custom in North Carolina operates on the premise that a check should not be paid after death of the drawer. This custom is supported by GS 105-24, a tax section, which states that a bank should not pay over any money after the death of a customer without retaining an amount to pay inheritance taxes.

Unless GS 105-24 is amended, GS 25-4-405 (2) will have little practical meaning.

Graham v. Hoke, 219 N.C. 755, 14 S.E.2d 790 (1941), is contrary to GS 25-4-405 (2), holding that death of a drawer revoked any authority of a bank to pay "a cheque."

**§ 25-4-406. Customer's duty to discover and report unauthorized signature or alteration.**—(1) When a bank sends to its customer a statement of account accompanied by items paid in good faith in support of the debit entries or holds the statement and items pursuant to a request or instructions of its customer or otherwise in a reasonable manner makes the statement and items available to the customer, the customer must exercise reasonable care and promptness to examine the statement and items to discover his unauthorized signature or any alteration on an item and must notify the bank promptly after discovery thereof.

(2) If the bank establishes that the customer failed with respect to an item to comply with the duties imposed on the customer by subsection (1) the customer is precluded from asserting against the bank

(a) his unauthorized signature or any alteration on the item if the bank also establishes that it suffered a loss by reason of such failure; and

(b) an unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank after the first item and statement was available to the customer for a reasonable period not exceeding fourteen calendar days and before the bank receives notification from the customer of any such unauthorized signature or alteration.

(3) The preclusion under subsection (2) does not apply if the customer establishes lack of ordinary care on the part of the bank in paying the item(s).

(4) Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statement and items are made available to the customer (subsection (1)) discover and report his unauthorized signature or any alteration on the face or back of the item or does not within three years from that time discover and report any unauthorized indorsement is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration.

(5) If under this section a payor bank has a valid defense against a claim of a customer upon or resulting from payment of an item and waives or fails upon request to assert the defense the bank may not assert against any collecting bank or other prior party presenting or transferring the item a claim based upon the unauthorized signature or alteration giving rise to the customer's claim. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. This section is new to Uniform Laws. It is to replace statutes in forty jurisdictions dealing with the general subject of a depositor's duty to discover and report forgeries and alterations. In these statutes there is substantial variation in rules prescribed as to the following matters: application of the statute to unauthorized signatures, raised checks or altered checks; inclusion of special provisions with respect to fictitious payees; periods of time prescribed for termination of right of customer to assert claims against bank; time when limitation period begins to run; restriction of rights of customer stated in terms of liability for loss, preclusion of rights or limitations on time in which suits may be brought.

2. Subsection (1) states the general duty of a customer to exercise reasonable care and promptness to examine his bank statements and items to discover his unauthorized signature or any alteration and to promptly notify the bank if he discovers an unauthorized signature or alteration. This duty becomes operative when the bank does any one of three things with respect to the statement of account and supporting items paid in good faith. The first action is the sending of the statement and items to the customer. The sending may be either by mailing or any other action within the definition of "send" (Section 1-201). The second action is the holding of such statement and items available for the customer pursuant to a request for instructions of the customer. The third action is stated as "or otherwise in a reasonable manner makes the statement and items available to the customer." Such wider residual language is desirable to cover unusual situations. An example might be where the bank knows a cus-

tomers has left a former address but does not know any new address to which to send the statement or item or to obtain instructions from the customer. The third residual type of action, however, must be "reasonable" and any court has the power to determine that a particular action or practice of a bank, other than sending statements and items or holding them pursuant to instructions, is not reasonable.

3. Subsection (2) states the effect of a failure of a customer to comply with subsection (1). The first effect stated in subparagraph (a) is that he is precluded from asserting against the bank his unauthorized signature and alteration if the bank establishes that it suffered a loss by reason of the customer's failure. The bank has the burden of establishing that it suffered some loss.

Under subparagraph (b) if, after the first item and statement becomes available plus a reasonable period not exceeding fourteen calendar days, the bank pays in good faith any other item on which there is an unauthorized signature or alteration by the same wrongdoer, which payment is prior to receipt by the bank of notification of such unauthorized signature or alteration on the first item the customer is precluded from asserting the additional unauthorized signature or alteration. This rule follows substantial case law that payment of an additional item or items bearing an unauthorized signature or alteration by the same wrongdoer is a loss suffered by the bank traceable to the customer's failure to exercise reasonable care in examining his statement and notifying the bank of objections to it. One of the most serious consequences of failure of the customer to comply with the requirements of subsection (1) is the opportunity presented to the wrongdoer to repeat his misdeeds. Conversely, one of the best ways



to keep down losses in this type of situation is for the customer to promptly examine his statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop paying further items. Hence, the rule of subparagraph (b) is prescribed and to avoid dispute a specific time limit for action by the customer is designated, namely fourteen calendar days.

4. The two effects on the customer of his failure to comply with subsection (1) (subparagraphs (a) and (b) of subsection (2)) are stated in terms of preclusion from asserting a claim against the bank. However, these two effects occur only if the customer has failed to exercise reasonable care and promptness in examining his statement and items and notifying the bank and as to this question of fact the burden is upon the bank to establish such failure. Further, even if the bank succeeds in establishing that the customer has failed to exercise ordinary care, if in turn the customer succeeds in establishing that the bank failed to exercise ordinary care in paying the item(s) the preclusion rule does not apply. This distribution of the burden of establishing between the customer and the bank provides reasonable equality of treatment and requires each person asserting the negligence to establish such negligence rather than requiring either person to establish that his entire course of conduct constituted ordinary care.

5. Whether the preclusion rule of subsection (2) operates or does not operate depends upon determinations as to ordinary care of the customer and possibly of the bank. However, subsection (4) places an absolute time limit on the right of a customer to make claim for payment of altered or forged paper without regard to care or lack of care of either the customer or the bank. In the case of alteration or the unauthorized signature of the customer himself the absolute time limit is one year. In the case of unauthorized indorsements it is three years. This recognizes that there is little excuse for a customer not detecting an alteration of his own check or a forgery of his own signature. However, he does not know the signatures of indorsers and may be delayed in learning that indorsements are forged. The three year absolute time limit on the discovery of forged indorsements should be ample, because in the great preponderance of cases the customer will learn of the forged indorsements within this time and if in any exceptional case he does not, the balance in favor of a mechanical termination of the liability of the bank outweighs what few residuary

risks the customer may still have. In thirteen of the existing statutes there are limitations on the liability of a bank for payment of items bearing forged indorsements which limitation periods range from thirty days to two years. In the remaining twenty-seven no provision is made for forged indorsements.

6. Nothing in this section is intended to affect any decision holding that a customer who has notice of something wrong with an indorsement must exercise reasonable care to investigate and to notify the bank. It should be noted that under the rules relating to impostors and signatures in the name of the payee (Section 3—405) certain forged indorsements on which the bank has paid the item in good faith may be treated as effective notwithstanding such discovery and notice. If the alteration or forgery results from the drawer's negligence the drawee who pays in good faith is also protected. Section 3—406.

7. The forty existing statutes on the subject as well as Section 4—406 evidence a public policy in favor of imposing on customers the duty of prompt examination of their bank statements and the notification of banks of forgeries and alterations and in favor of reasonable time limitations on the responsibility of banks for payment of forged or altered items. In two New York cases, however, it has been held that a payor bank may waive defenses of the kind prescribed by the section and ignore the public policy indicated by these defenses and recover the full amount of a forged or altered item from a collecting bank. *Fallick v. Amalgamated Bank of New York*, 232 App. Div. 127, 249 N.Y.S. 238 (1st Dep't. 1931); *National Surety Corp. v. Federal Reserve Bank of New York*, 188 Misc. 207, 70 N.Y.S.2d 636 (1946), affirmed without opinion 188 Misc. 213, 70 N.Y.S.2d 642 (1946). Subsection (5) is intended to reject the holding of these and like cases. Although the principle of subsection (5) might well be applied to other types of claims of customers against banks and defenses to these claims, the rule of the subsection is limited to defenses of a payor bank under this section. No present need is known to give the rule wider effect.

#### Cross references:

Sections 3—404, 3—405, 3—406, 3—407, 3—417 and 4—207.

#### Definitional cross references:

"Alteration". Section 3—407.

"Bank". Section 1—201.

"Collecting bank". Section 4—105.

"Customer". Section 4—104.

"Good faith". Section 1—201.

"Indorsement". Section 3—204.

"Item". Section 4—104.

"Payor bank". Section 4—105.

"Send". Section 1—201.

"Unauthorized signature". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection takes the place of GS 53-76, which also places a general duty of due care on a depositor to inspect vouchers and promptly report any errors.

*Subsection (2):* Subsection (2) (b) changes the rule of GS 53-52 on the time within which a depositor must report his own unauthorized signature: GS 53-52 uses an automatic 60-day test, i.e., (a) for forgeries reported within 60 days of day the customer receives his voucher, he can recover; but (b) for forgeries not reported within the 60 days, he cannot recover.

When there has been a series of unauthorized signatures or alterations by the same person, subsection (2) (b) has a special rule. It provides, in effect, that a depositor cannot recover payments made by the bank during a period of time commencing with 14 days after the customer has first received one such item and ending with the time that the bank receives notice. These rules apply only if the customer has been negligent under subsection (1).

*Subsection (3):* A depositor has three

years to report an unauthorized *indorsement*. A bank may not show that its customer is "precluded" if the customer establishes lack of ordinary care on the part of the bank.

*Subsection (4):* As in subsection (2) (b), this subsection (4) changes the rule of GS 53-52 on the time within which a depositor must report his own unauthorized signature. (See subsection (2) (b) above.)

Even within the one-year, three-year, and 14-day periods, the depositor must still use "reasonable care and promptness."

The decision of *Schwabenton v. Security Nat'l Bank*, 251 N.C. 655, 111 S.E.2d 856 (1960), is changed by GS 25-4-406.

*Subsection (5):* This subsection prevents a bank that can make itself whole against its customer from recovering from collecting banks or other prior parties.

GS 53-75 (statement of account from bank to depositor deemed final adjustment if not objected to within five years) will still cover irregularities other than unauthorized signatures and alterations.

**§ 25-4-407. Payor bank's right to subrogation on improper payment.**—If a payor bank has paid an item over the stop payment order of the drawer or maker or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank shall be subrogated to the rights

- (a) of any holder in due course on the item against the drawer or maker; and
- (b) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and
- (c) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. Section 4—403 states that a stop payment order is binding on a bank. If a bank pays an item over such a stop order it is *prima facie* liable, but under subsection (3) of 4—403 the burden of establishing the fact and amount of loss from such payment is on the customer. A defense frequently interposed by a bank in an action against it for wrongful payment over a stop-order is that the drawer or maker suffered no loss because he would have been liable to a holder in due course in any event. On this argument some cases

have held that payment cannot be stopped against a holder in due course. Payment can be stopped, but if it is, the drawer or maker is liable and the sound rule is that the bank is subrogated to the rights of the holder in due course. The preamble and subsection (a) of this section state this rule.

2. Subsection (b) also subrogates the bank to the rights of the payee or other holder against the drawer or maker either on the item or under the transaction out of which it arose. It may well be that the payee is not a holder in due course but still has good rights against the drawer.

These may be on the check but also may not be as, for example, where the drawer buys goods from the payee and the goods are partially defective so that the payee is not entitled to the full price, but the goods are still worth a portion of the contract price. If the drawer retains the goods he is obligated to pay a part of the agreed price. If the bank has paid the check it should be subrogated to this claim of the payee against the drawer.

3. Subsection (c) subrogates the bank to the rights of the drawer or maker against the payee or other holder with respect to the transaction out of which the item arose. If, for example, the payee was a fraudulent salesman inducing the drawer to issue his check for defective securities, and the bank pays the check over a stop order but reimburses the drawer for such payment, the bank should have a basis for getting the money back from the fraudulent salesman.

#### NORTH CAROLINA COMMENT

This section is closely related to GS 25-4-403 on stop-orders.

Basically, the section is intended to prevent unjust enrichment, and it accomplishes this by allowing a payor bank that has made a wrongful payment to be subrogated to the rights of various other parties against others.

4. The limitations of the preamble prevent the bank itself from getting any double recovery or benefits out of its subrogation rights conferred by the section.

5. The spelling out of the affirmative rights of the bank in this section does not destroy other existing rights (Section 1-103). Among others these may include the defense of a payor bank that by conduct in recognizing the payment a customer has ratified the bank's action in paying in disregard of a stop payment order or rights to recover money paid under a mistake.

#### Cross reference:

Section 4-403.

#### Definitional cross references:

"Holder". Section 1-201.

"Holder in due course". Section 3-302.

"Item". Section 4-104.

"Payor bank". Section 4-105.

### PART 5.

#### COLLECTION OF DOCUMENTARY DRAFTS.

**§ 25-4-501. Handling of documentary drafts; duty to send for presentment and to notify customer of dishonor.**—A bank which takes a documentary draft for collection must present or send the draft and accompanying documents for presentment and upon learning that the draft has not been paid or accepted in due course must seasonably notify its customer of such fact even though it may have discounted or bought the draft or extended credit available for withdrawal as of right. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

#### Purposes:

To state the duty of a bank handling a documentary draft for a customer. "Documentary draft" is defined in Section 4-104. Notice that the duty stated exists even when the bank has bought the draft. This is because to the customer the draft normally represents an underlying commercial transaction, and if that is not going through as planned he should know it promptly.

#### Cross references:

In Article 4: Sections 4-201, 4-202, 4-203, 4-204 and 4-210.

In Article 5: Sections 5-110, 5-111, 5-112 and 5-113.

#### Definitional cross references:

"Documentary draft". Sections 4-104, 5-103.

#### NORTH CAROLINA COMMENT

Notice that the bank has a duty to notify its customer even when the bank has bought the dishonored draft. This is because the customer will normally be commercially interested in the fact of dis-

honor even though the customer is not to be held liable on the instrument.

See *Branch Bank & Trust Co. v. Bank of Washington*, 255 N.C. 205, 120 S.E.2d 830 (1961).



**§ 25-4-502. Presentment of "on arrival" drafts.**—When a draft or the relevant instructions require presentment "on arrival," "when goods arrive" or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must notify its transferor of such refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

The section is designed to establish a definite rule for "on arrival" drafts. The term includes not only drafts drawn payable "on arrival" but also drafts forwarded with instructions to present "on arrival". The term refers to the arrival of the relevant goods. Unless a bank has actual knowledge of the arrival of the goods, as for example, when it is the "notify" party on the bill of lading, the section only re-

quires the exercise of such judgment in estimating time as a bank may be expected to have. Commonly the buyer-drawee will want the goods and will therefore call for the documents and take up the draft when they do arrive.

**Cross references:**

In Article 4: Sections 4—202 and 4—203.  
In Article 5: Section 5—112.

**Definitional cross references:**

"Collecting bank". Section 4—105.

#### NORTH CAROLINA COMMENT

Notice the duty to notify of a refusal to pay even though the refusal does not amount to a dishonor.

**§ 25-4-503. Responsibility of presenting bank for documents and goods; report of reasons for dishonor; referee in case of need.**—Unless otherwise instructed and except as provided in article 5 a bank presenting a documentary draft

(a) must deliver the documents to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment; and

(b) upon dishonor, either in the case of presentment for acceptance or presentment for payment, may seek and follow instructions from any referee in case of need designated in the draft or if the presenting bank does not choose to utilize his services it must use diligence and good faith to ascertain the reason for dishonor, must notify its transferor of the dishonor and of the results of its effort to ascertain the reasons therefor and must request instructions.

But the presenting bank is under no obligation with respect to goods represented by the documents except to follow any reasonable instructions seasonably received; it has a right to reimbursement for any expense incurred in following instructions and to prepayment of or indemnity for such expenses. (1899, c. 733, s. 131; Rev., s. 2281; C. S., s. 3113; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 131(3), Uniform Negotiable Instruments Law.

**Changes:** Completely rewritten and enlarged.

**Purposes:**

1. To state the rules governing, in the absence of instructions, the duty of the presenting bank in case either of honor or of dishonor of a documentary draft. The section should be read in connection with Section 2—514 on when documents are deliverable on acceptance, when on payment.

2. If the draft is drawn under a letter of credit, Article 5 controls. See Sections 5—109 through 5—114.

**Cross references:**

Point 1. Section 2—514; see also Section 4—504.

Point 2. Article 5, especially Sections 5—109 through 5—114.

**Definitional cross references:**

"Documentary draft". Sections 4—104, 5—103.

"Presenting bank". Section 4—105.

## NORTH CAROLINA COMMENT

*Subsection (a):* This subsection varies the duty to deliver the accompanying documents according to whether the draft is payable more or not more than three days after presentment. This subsection should be read in conjunction with GS 25-2-514 on when documents are deliverable on acceptance and when only on payment.

§ 25-4-504. **Privilege of presenting bank to deal with goods; security interest for expenses.**—(1) A presenting bank which, following the dishonor of a documentary draft, has seasonably requested instructions but does not receive them within a reasonable time may store, sell, or otherwise deal with the goods in any reasonable manner.

(2) For its reasonable expenses incurred by action under subsection (1) the presenting bank has a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

To give the presenting bank, after dishonor, a privilege to deal with the goods in any commercially reasonable manner pending instructions from its transferor and, if still unable to communicate with its principal after a reasonable time, a right to realize its expenditures as if foreclosing on an unpaid seller's lien (Section 2-706). The provision includes situations in which storage of goods or other action becomes commercially necessary pending

receipt of any requested instructions, even if the requested instructions are later received.

The "reasonable manner" referred to means one reasonable in the light of business factors and the judgment of a business man.

**Cross references:**

Sections 4-503 and 2-706.

**Definitional cross references:**

"Presenting bank". Section 4-105.

"Documentary draft". Sections 4-104, 5-103.

## NORTH CAROLINA COMMENT

This section gives protection to a bank that has reasonably dealt with goods. Expenditures may be realized by the bank as

if foreclosing an unpaid seller's lien under GS 25-2-706.

## ARTICLE 5.

*Letters of Credit.*

## NORTH CAROLINA COMMENT

A brief outline of letters of credit may serve to explain the coverage of article 5. First, it is estimated that today ninety percent of imports are financed by letters of credit. Also the letter of credit is becoming more important in the domestic field.

The device takes two forms: (a) A "documentary" letter and (b) a "clean" letter.

The documentary letter helps in financing arrangements when a buyer is unwilling to pay before goods are shipped and when the seller is unwilling to ship without guarantee of payment. In such case an *issuer* (bank or other financier) at the request of its *customer* (buyer) issues a letter which is its promise to the *beneficiary* (seller) that it will accept or pay drafts drawn on it by the beneficiary under stated conditions if the drafts are accompanied by the appropriate documents (invoice, bill of lading, etc.).

Often an *advising* bank near the seller will be selected to notify the seller of the letter of credit. If the bank near the seller also engages that it will honor the credit of the issuer, the advising bank becomes a *confirming* bank.

Because the letter of credit is an evolving financial paper, needing room for experimentation, the rules governing it are purposely drawn quite loosely. Official Comment 2 to GS 25-5-102 states the growth aspect.

§ 25-5-101. **Short title.**—This article shall be known and may be cited as Uniform Commercial Code—Letters of Credit. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

Letters of credit have been known and used for many years, in both international and domestic transactions, and in many forms; but except for a few provisions, like Section 135 of the Negotiable Instruments Law, they have not been the subject of statutory enactment, and the law concerning them has been developed in the cases.

This provision of the Negotiable Instruments Law is no longer in the Code. See the contrary rule in Section 3—410 on the

definition of acceptance. The other source of law respecting letters of credit is the law of contracts with occasional unfortunate excursions into the law of guaranty. This Article is intended within its limited scope (see Comment to Section 5—102) to set an independent theoretical frame for the further development of letters of credit.

## Cross references:

Sections 5—102, 5—103 and 3—410.

## § 25-5-102. Scope.—(1) This article applies

(a) to a credit issued by a bank if the credit requires a documentary draft or a documentary demand for payment; and

(b) to a credit issued by a person other than a bank if the credit requires that the draft or demand for payment be accompanied by a document of title; and

(c) to a credit issued by a bank or other person if the credit is not within subparagraphs (a) or (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled.

(2) Unless the engagement meets the requirements of subsection (1), this article does not apply to engagements to make advances or to honor drafts or demands for payment, to authorities to pay or purchase, to guarantees or to general agreements.

(3) This article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this chapter or may hereafter develop. The fact that this article states a rule does not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this article. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

Prior uniform statutory provision: None.

## Purposes:

To define the transactions to which this Article applies and to indicate that the rules stated are not intended to be exhaustive of the law applicable to letters of credit.

1. Although letters of credit are commonly thought of as being issued by banks and private bankers, other financing institutions can and do enter into transactions which fit the traditional concept of letters of credit. This is particularly true when the financing institution at the request of a buyer of goods promises the seller of the goods that it will pay or accept drafts or demands for payment on either the buyer or itself if the drafts are accompanied by documents of title covering the goods involved in the sales contract. Banks and private bankers also issue money credits which do not require documents of title to be presented as one of the conditions of honor. So far as these institutions are concerned the accompanying papers can range from a certification that certain building contracts have been performed in whole or in part or a notice that goods have been sent or a notice of

default of some kind into the more traditional document of title. Subsection (1) attempts to make clear that automatic application of this Article to the transaction in question depends upon the nature of the issuer. Paragraph (1) (a) is applicable to banks and states that whenever the promise to honor is conditioned on presentation of any piece of paper, the transaction is within this Article whereas paragraph (1) (b) makes automatic application of the Article to transactions involving issuers other than banks dependent upon the requirement of a document of title.

Since banks issue "clean" as well as "documentary" credits and since other persons may desire to bring transactions involving papers other than documents of title within the coverage of this Article, paragraph (1) (c) permits the issuer to do so by conspicuous notation that the paper is a letter of credit. Whether a transaction falls within the mandatory or the permissive paragraphs of subsection (1) is also of importance on the question of payment of funds held by an issuer at the time of its insolvency (See Section 5—117).

Subsection (2) states the negative of



the rules of applicability of subsection (1) for greater clarity but is not intended to either enlarge or limit the tests of applicability there laid down.

2. Subsection (3) recognizes that in the present state of the law and variety of practices as to letters of credit, no statute can effectively or wisely codify all the possible law of letters of credit without stultifying further development of this useful financing device. The more important areas not covered by this Article revolve around the question of when documents in fact and in law do or do not comply with the terms of the credit. In addition such minor matters as the absence of expiration dates and the effect of extending shipment but not expiration dates are also left untouched for future adjudication. The rules embodied in the Article can be viewed as those expressing the fundamental theories underlying letters of credit. For this reason the second sentence of subsection (3) makes explicit the court's power to

apply a particular rule by analogy to cases not within its terms, or to refrain from doing so. Under Section 1-102(1) such application is to follow the canon of liberal interpretation to promote underlying purposes and policies. Since the law of letters of credit is still developing, conscious use of that canon and attention to fundamental theory by the court are peculiarly appropriate.

**Cross reference:**

Section 1-102.

**Definitional cross references:**

"Agreement". Section 1-201.

"Bank". Section 1-201.

"Conspicuous". Section 1-201.

"Credit". Section 5-103.

"Documentary draft". Section 5-103.

"Document of title" Section 1-201.

"Draft". Section 3-104.

"Honor". Section 1-201.

"Person". Section 1-201.

**NORTH CAROLINA COMMENT**

Under subsection (1) the applicability of article 5 depends on the nature of the issuer and the nature of the credit issued:

(a) Paragraph (1) (a) includes "documentary" letters by banks.

(b) Paragraph (1) (b) includes documentary credits by nonbanks.

(c) Paragraph (1) (c) includes so-called "clean" letters by both banks and nonbanks.

*Possible amendment:* The Permanent

Editorial Board has rejected an amendment proposed by and adopted by New York which would exclude from the operation of article 5 a credit subject to the *Uniform Customs and Practice for Commercial Documentary Credits* fixed by the Thirteenth or by any subsequent Congress of the International Chamber of Commerce. See Report No. 1 of Permanent Editorial Board 81-6.

**§ 25-5-103. Definitions.**—(1) In this article unless the context otherwise requires

(a) "Credit" or "letter of credit" means an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this article (§ 25-5-102) that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. A credit may be either revocable or irrevocable. The engagement may be either an agreement to honor or a statement that the bank or other person is authorized to honor.

(b) A "documentary draft" or a "documentary demand for payment" is one honor of which is conditioned upon the presentation of a document or documents. "Document" means any paper including document of title, security, invoice, certificate, notice of default and the like.

(c) An "issuer" is a bank or other person issuing a credit.

(d) A "beneficiary" of a credit is a person who is entitled under its terms to draw or demand payment.

(e) An "advising bank" is a bank which gives notification of the issuance of a credit by another bank.

(f) A "confirming bank" is a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank.

(g) A "customer" is a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank's customer.

(2) Other definitions applying to this article and the sections in which they appear are:

“Notation of credit.” § 25-5-108.

“Presenter.” § 25-5-112 (3).

(3) Definitions in other articles applying to this article and the sections in which they appear are:

“Accept” or “Acceptance.” § 25-3-410.

“Contract for sale.” § 25-2-106.

“Draft.” § 25-3-104.

“Holder in due course.” § 25-3-302.

“Midnight deadline.” § 25-4-104.

“Security.” § 25-8-102.

(4) In addition, article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

To define terms used in this Article.

1. Paragraph (a) of subsection (1) in defining a “credit” or “letter of credit” sets forth the requirement that the engagement of the bank or other person to honor drafts or other demands for payment be at the request of another and involve a transaction falling within the scope of this Article (Section 5—102). It then makes clear that the “engagement” may be by way of agreement, that is, a promise to honor, or by way of an authority to honor, thus including within the definition of letter of credit, papers called “authorities to purchase or pay”. The definition also makes clear that the engagement may be either revocable or irrevocable, the legal consequences of which are spelled out in Section 5—106 on the time and effect of establishment of a credit. Neither the definition nor any other section of this Article deals with the issue of when a credit, not clearly labelled as either revocable or irrevocable falls within the one or the other category although the Code settles this issue with respect to the sales contract (Section 2—325). This issue so far as it affects an issuer under this Article is intentionally left to the courts for decision in the light of the facts and general law (Section 1—103) with due regard to the general provisions of the Code in Article 1 particularly Section 1—205 on course of dealing and usage of trade.

2. Paragraph (b) is intended to show that the word “document” is far broader than “document of title” for the purposes of this Article. This is of special importance with respect to the application of the Article to banks under Section 5—102(1) (a) and differs from the definition of “document” in Article 9 on secured transactions which is there limited to documents of title. See Section 9—105(1) (e).

3. The legal relations between the issuer (1) (c) and the beneficiary (1) (d) and between the issuer and the customer (1) (g) are spelled out in other sections of this Article. The legal relations between the customer and the beneficiary turn on the underlying transaction between them: if that transaction be one of sale of goods, their rights depend upon Article 2; if the transaction involves the sale of investment securities, Article 8 will be applicable; if the transaction involves the transfer of commercial paper, Article 3 will be applicable; if documents of title are transferred, Article 7 will be applicable; and if the transaction is intended to create a security interest, Article 9 will apply. The issuer is not a guarantor of the performance of these underlying transactions. See Section 5—109.

4. The definition of customer in subsection (1) (g) is explicitly made to include a bank which is acting for its customer, so that a particular transaction may well involve a metropolitan issuing bank and two customers, one of whom is the ultimate customer as, e.g., the buyer of goods and the other of whom is the buyer's local bank which has requested the metropolitan bank to issue the credit.

5. The definitions of “advising” and “confirming” banks in subsection (1) (e) and (f) do not include a statement of their legal consequences. These are set out primarily in Section 5—107 on advice of credit, confirmation; error in statement.

#### Cross references:

Point 1: Sections 5—102, 5—106, 1—103, 1—205, 2—325 and Article 1.

Point 2: Sections 5—102, 1—201 and 9—105.

Point 3: Articles 2, 3, 7, 8 and 9; Section 5—109.

Point 5: Section 5—107.

**Definitional cross references:**

"Agreement". Section 1—201.

"Bank". Section 1—201.

"Document of title". Section 1—201.

"Gives notification". Section 1—201.

"Honor". Section 1—201.

"Person". Section 1—201.

**NORTH CAROLINA COMMENT**

Paragraph (b) is intended to show that the word "document" is broader than "document of title" for purposes of this article. This is especially important with respect to GS 25-5-102 (1) (a); and the

broadened definition is different from the definition of "document" in article 9 on secured transaction which refers only to "documents of title." See GS 25-9-105 (1) (e).

**§ 25-5-104. Formal requirements; signing.**—(1) Except as otherwise required in subsection (1) (c) of § 25-5-102 on scope, no particular form of phrasing is required for a credit. A credit must be in writing and signed by the issuer and a confirmation must be in writing and signed by the confirming bank. A modification of the terms of a credit or confirmation must be signed by the issuer or confirming bank.

(2) A telegram may be a sufficient signed writing if it identifies its sender by an authorized authentication. The authentication may be in code and the authorized naming of the issuer in an advice of credit is a sufficient signing. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. Subsection (1) is to make clear that, except for the statement or title required by Section 5—102(1) (c) to bring certain transactions within the scope of this Article, no particular form need be followed; it is sufficient that the credit is in writing and signed by the issuer. The subsection also states that any modification is subject to the same requirements of signing and writing. Compare Section 2—209(3) on sale of goods. Questions of mistake, waiver or estoppel are left to supplementary principles of law. See Section 1—103.

2. Subsection (2), although perhaps unnecessary in view of the definition of "signed" in Section 1—201, is inserted

here to make certain that code and authorized naming of an issuer is a sufficient signing. These forms of signing are so customary that their explicit inclusion is useful to eliminate all controversy on the point.

**Cross references:**

Point 1: Sections 5—102, 2—209, 1—103.

Point 2: Section 1—201.

**Definitional cross references:**

"Confirming bank". Section 5—103.

"Credit". Section 5—103.

"Issuer". Section 5—103.

"Signed". Section 1—201.

"Telegram". Section 1—201.

"Term". Section 1—201.

"Writing". Section 1—201.

**NORTH CAROLINA COMMENT**

This section does not attempt to cover questions of mistake, waiver or estoppel

which are left to other principles of law. See GS 25-1-103.

**§ 25-5-105. Consideration.**—No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

It is not to be expected that a financial institution will engage its credit without some form of expected remuneration. But it is not expected that the beneficiary will know what the issuer's remuneration was, or whether in fact there was any identifi-

able remuneration in a given case. And it would be extraordinarily difficult for the beneficiary to *prove* the issuer's remuneration. This section dispenses with such proof.

**Definitional cross references:**

"Credit". Section 5—103.

"Terms". Section 1—201.

**§ 25-5-106. Time and effect of establishment of credit.**—(1) Unless otherwise agreed a credit is established

(a) as regards the customer as soon as a letter of credit is sent to him or the



letter of credit or an authorized written advice of its issuance is sent to the beneficiary; and

(b) as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance.

(2) Unless otherwise agreed once an irrevocable credit is established as regards the customer it can be modified or revoked only with the consent of the customer and once it is established as regards the beneficiary it can be modified or revoked only with his consent.

(3) Unless otherwise agreed after a revocable credit is established it may be modified or revoked by the issuer without notice to or consent from the customer or beneficiary.

(4) Notwithstanding any modification or revocation of a revocable credit any person authorized to honor or negotiate under the terms of the original credit is entitled to reimbursement for or honor of any draft or demand for payment duly honored or negotiated before receipt of notice of the modification or revocation and the issuer in turn is entitled to reimbursement from its customer. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

To define when a letter of credit is established in relation to the customer and the beneficiary, and to set forth for both irrevocable and revocable credits the legal consequences of the fact of establishment.

1. The primary purpose of determining the time of establishment of an irrevocable credit is to determine the point at which the issuer is no longer free to take unilateral action with respect to the cancellation of the credit or modification of its terms. So far as the customer is concerned this point of time is reached when the issuer "sends" (as that term is defined in Section 1—201) the credit or when its authorized agent, the advising bank, sends the advice of the credit to the beneficiary. Since the sending is pursuant to an agreement between the issuer and the customer, it is the issuer's performance of the first stage of the contract and under Section 5—107 (4) the risk of transmission is on the customer. The beneficiary, however, cannot rely upon the credit until and unless he receives it. His right to protest to the issuer in the event of cancellation or modification, therefore, turns on receipt. Nothing in this section affects the beneficiary's right to protest the improper nature of the credit or its cancellation (i.e., its non-receipt) as against the customer, who will normally have agreed to have a letter of credit issued in favor of the beneficiary under some underlying contract. See, e. g., Section 2—325(1) on buyer's failure to seasonably furnish an agreed letter of credit pursuant to a sales contract.

2. So far as a revocable letter of credit

is concerned, the rules stated in subsections (3) and (4) are intended to show that so far as the customer or beneficiary is concerned establishment of such a credit has no legal significance unless the parties provide otherwise in their contracts with the issuer. The primary significance of the establishment of a revocable letter of credit is the obligation it imposes upon the issuer to innocent third parties who have negotiated or honored drafts drawn under the credit before receiving notice of its cancellation or change. The purpose of this rule is to further the movement of goods which the underlying transaction typically envisages and to preserve the solidity of American credits. As a necessary consequence of the imposition of this duty upon the issuer, a duty of reimbursement of the issuer is placed upon the customer by explicit mention here even though it would fall within the general duty of reimbursement imposed by Section 5—114(3).

**Cross references:**

Point 1: Sections 5—107, 2—325.

Point 2: Section 5—114.

**Definitional cross references:**

"Beneficiary". Section 5—103.

"Credit". Section 5—103.

"Customer". Section 5—103.

"Draft". Section 3—104.

"Honor". Section 1—201.

"Issuer". Section 5—103.

"Notice". Section 1—201.

"Person". Section 1—201.

"Receive notice". Section 1—201.

"Send". Section 1—201.

"Written". Section 1—201.

## NORTH CAROLINA COMMENT

The time of establishing an irrevocable credit is the time at which the issuer is no longer free to take unilateral action in cancelling or modifying the credit.

**§ 25-5-107. Advice of credit; confirmation; error in statement of terms.**—(1) Unless otherwise specified an advising bank by advising a credit issued by another bank does not assume any obligation to honor drafts drawn or demands for payment made under the credit but it does assume obligation for the accuracy of its own statement.

(2) A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer.

(3) Even though an advising bank incorrectly advises the terms of a credit it has been authorized to advise the credit is established as against the issuer to the extent of its original terms.

(4) Unless otherwise specified the customer bears as against the issuer all risks of transmission and reasonable translation or interpretation of any message relating to a credit. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. An "advising bank" is defined in Section 5—103. Subsection (1) of this section states its obligations to transmit accurately but not to honor drafts. The advice may of course not be accurate. The advising bank is responsible for its own error; under subsection (3), however, the issuer is bound to honor only in accordance with the original terms of the credit.

2. A "confirming bank" is defined in Section 5—103. Subsection (2) of this section states its obligations and rights. The obligation, to the extent of the confirmation, is that of an issuer and so too is the right of reimbursement. The most important aspect of this rule is that a beneficiary who has received a confirmed credit has the independent engagements of both the issuer and the confirming bank. A confirming bank may of course be an advising

bank so far as the issuer's engagement is concerned but this is rarely of importance because its own engagement if the terms be improperly advised will be to honor in accordance with those terms.

3. Subsection (4) distributes the risks, as between customer and issuer, of errors in transmission and translation by placing them on the customer in the absence of specific agreement to the contrary. See also Section 5—109(1) (b).

**Cross references:**

Sections 5—103 and 5—109.

**Definitional cross references:**

"Advising bank". Section 5—103.

"Bank". Section 1—201.

"Confirming bank". Section 5—103.

"Credit". Section 5—103.

"Customer". Section 5—103.

"Draft". Section 3—104.

"Honor". Section 1—201.

"Issuer". Section 5—103.

## NORTH CAROLINA COMMENT

"Advising bank" is defined in GS 25-5-103. Subsection (1) states such bank's obligation is to merely transmit, not honor, drafts.

"Confirming bank" is defined in GS 25-5-103; and GS 25-5-107 (2) states that such

bank is liable to the extent of its confirmation. Thus, a beneficiary who has received a confirmed credit has the independent engagements of both the issuing bank and the confirming bank.

**§ 25-5-108. "Notation credit"; exhaustion of credit.**—(1) A credit which specifies that any person purchasing or paying drafts drawn or demands for payment made under it must note the amount of the draft or demand on the letter or advice of credit is a "notation credit."

(2) Under a notation credit

(a) a person paying the beneficiary or purchasing a draft or demand for payment from him acquires a right to honor only if the appropriate notation is made and by transferring or forwarding for honor the documents under the credit such a person warrants to the issuer that the notation has been made; and

(b) unless the credit or a signed statement that an appropriate notation has

been made accompanies the draft or demand for payment the issuer may delay honor until evidence of notation has been procured which is satisfactory to it but its obligation and that of its customer continue for a reasonable time not exceeding thirty days to obtain such evidence.

(3) If the credit is not a notation credit

(a) the issuer may honor complying drafts or demands for payment presented to it in the order in which they are presented and is discharged pro tanto by honor of any such draft or demand;

(b) as between competing good faith purchasers of complying drafts or demands the person first purchasing has priority over a subsequent purchaser even though the later purchased draft or demand has been first honored. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. Practice has varied in regard to requiring notation on a letter of credit of the drafts drawn thereunder, and dispute has been rife for more than a century over the effect of failure by a purchaser to make such notations when they are required. The confusion has been due to a failure to distinguish two different types of credit and the different results which flow from each.

Under subsection (3), if an issuer chooses to issue a credit not requiring notation or if the credit is available in portions (see Section 5—110) without requirement of notation the issuer avoids all troubles attendant on any purchaser's failure to make notations, but he also imperils the utility of the credit to a beneficiary by reason of its possible exhaustion before any particular purchaser may have discounted drafts under it, so that there may be no market at all for such drafts. Yet this way of operation becomes useful and desirable at least whenever the credit is "domiciled," i.e., when it is explicitly made available only through one particular named correspondent, who will have his own records of prior drafts.

Subsection (3) expressly protects the issuer under such a credit (almost exactly as in the case of drafts drawn in a set under Section 3—801) in regard to any drafts which he honors in good faith, even though they are in the hands of a party who as against some other purchaser of drafts is not entitled to their proceeds. Similarly, in the last sentence, the rights of successive

good faith purchasers are regulated as with drafts in a set.

2. Under subsection (2), on the other hand, the notation machinery is made available where the credit provides for notation in accordance with subsection (1). This is useful particularly where the credit is intended (as a traveler's letter would be) for roving use, but the responsibility is put upon the purchaser to make the appropriate notation on pain of reimbursing the issuer for any loss occasioned by the failure. The provision in regard to delay of honor while evidence of notation is being procured is novel in the law, but is believed to be a necessary addition first, to protect the issuer, and second, to educate purchasers.

Subsection (2) (a) avoids a difficult question of conflict of laws by making the obligation to note a condition of the credit itself, governed, therefore, by the law which controls the issue of the credit.

#### Cross references:

Sections 3—801 and 5—110.

#### Definitional cross references:

"Beneficiary". Section 5—103.

"Credit". Section 5—103.

"Customer". Section 5—103.

"Document". Section 5—103.

"Draft". Section 3—104.

"Good faith". Section 1—201.

"Honor". Section 1—201.

"Issuer". Section 5—103.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Purchaser". Section 1—201.

"Rights". Section 1—201.

"Signed". Section 1—201.

#### NORTH CAROLINA COMMENT

Subsections (1) and (2) set forth certain rights and duties of parties under a "notation credit."

Subsection (3) covers a non-notation letter of credit. Of special importance under the non-notation credit is the rule of

paragraph (b) stating a "first in time—first in right" rule among several purchasers.

Because of the dangers to one buying drafts under the non-notation draft, their marketability is cut down.

**§ 25-5-109. Issuer's obligation to its customer.**—(1) An issuer's obligation to its customer includes good faith and observance of any general banking usage but unless otherwise agreed does not include liability or responsibility



(a) for performance of the underlying contract for sale or other transaction between the customer and the beneficiary; or

(b) for any act or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others; or

(c) based on knowledge or lack of knowledge of any usage of any particular trade.

(2) An issuer must examine documents with care so as to ascertain that on their face they appear to comply with the terms of the credit but unless otherwise agreed assumes no liability or responsibility for the genuineness, falsification or effect of any document which appears on such examination to be regular on its face.

(3) A non-bank issuer is not bound by any banking usage of which it has no knowledge. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

Prior uniform statutory provision: None.

##### Purposes:

1. The extent of the issuer's obligation to its customer is based upon the agreement between the two. Like all agreements within the Code, that agreement is the bargain of the parties in fact as defined in Section 1—201(3) and includes the obligation of good faith imposed by Section 1—203 and the observance of any course of dealing or usage of trade made applicable by Section 1—205. Subsection (1) of this section states, as a particular application of those general rules, the issuer's standard obligation of good faith and observance of general banking usage. Disclaimer of the obligation of good faith is governed by Section 1—102(3); conflict between express terms and a usage otherwise applicable is governed by Section 1—205(4).

Subsection (1) also clarifies the areas over which the issuer assumes no liability or responsibility except as the agreement of the parties may indicate the contrary. Paragraph (a) rests on the assumptions that the issuer has had no control over the making of the underlying contract or over the selection of the beneficiary, and that the issuer receives compensation for a payment service rather than for a guaranty of performance. The customer will normally have direct recourse against the beneficiary if performance fails, whereas the issuer will have such recourse only by assignment of or in a proper case subrogation to the rights of the customer.

Paragraph (b) also rests in part on the assumption that the issuer has not selected the other persons who may be involved in the transaction. Even though this assumption fails, however, as where the issuer selects the advising bank, the customer by entering the underlying transaction has assumed the risks inherent in it, including the risk of loss or destruction of the papers involved. The allocation of such risks be-

tween the parties to the underlying transaction is a proper subject for agreement between them, and the small charge for the issuance of a letter of credit ordinarily indicates that the issuer assumes minimum risks as against its customer. For comparable reasons Section 5—107(4) puts risks of transmission and translation upon the customer.

Paragraph (c) again emphasizes that normally an issuer performs a banking and not a trade function. This paragraph makes an exception to Section 1—205(3), giving effect to usages of which the parties "are or should be aware." The comparable provision for non-bank issuers in subsection (3) of this section is limited to unknown banking usages and is thus merely a definition of a particular type of case not included by the words "should be aware" in Section 1—205(3).

2. Subsection (2) states the basic obligation of the issuer to examine with care the documents required under the credit. Under Section 1—102(3) this obligation cannot be disclaimed but standards of performance can be determined by agreement if not manifestly unreasonable. There are not infrequent cases in which both parties understand that peculiar circumstances make any check-up on some particular type of document impossible and it is agreed that the issuer may take it "as presented" —so, e.g., export licenses in politically disturbed conditions, or "shipping documents" when no document in standard or regular form can be procured. These agreements will be controlling provided they are not manifestly unreasonable.

The purpose of the examination is to determine whether the documents appear regular on their face. The fact that the documents may be false or fraudulent or lacking in legal effect is not one for which the issuer is bound to examine. His duty is limited to apparent regularity on the face

of the documents. The duties, privileges and rights of an issuer who has received documents which are regular on their face but are in fact improper because forged or fraudulent are dealt with in Section 5—114.

**Cross references:**

Point 1: Sections 1—102, 1—201, 1—203, 1—205, 5—107.

Point 2: Sections 1—102, 5—114.

**Definitional cross references:**

"Bank". Section 1—201.

"Beneficiary". Section 5—103.

"Branch". Section 1—201.

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Credit". Section 5—103.

"Customer". Section 5—103.

"Document". Section 5—103.

"Draft". Section 3—104.

"Genuine". Section 1—201.

"Good faith". Section 1—201.

"Issuer". Section 5—103.

"Knowledge". Section 1—201.

"Person". Section 1—201.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

This section provides that in the absence of any agreement to the contrary, the issuer is liable only for its own conduct; and it must exercise only good faith observing general banking usage.

See also GS 25-5-114 on issuer's duty and privilege to honor.

**§ 25-5-110. Availability of credit in portions; presenter's reservation of lien or claim.**—(1) Unless otherwise specified a credit may be used in portions in the discretion of the beneficiary.

(2) Unless otherwise specified a person by presenting a documentary draft or demand for payment under a credit relinquishes upon its honor all claims to the documents and a person by transferring such draft or demand or causing such presentment authorizes such relinquishment. An explicit reservation of claim makes the draft or demand noncomplying. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. The beneficiary may desire to draw more than one draft under the credit, each draft accompanied, for instance, by documents evidencing a single shipment under the underlying sales contract. Subsection (1) makes clear that unless otherwise specified he may do so. Of course, if he does, each draft and its accompanying documents must satisfy the terms of the credit and their total must not exceed its amount. See Comment to Section 5—108(3) on exhaustion of a credit on the rule governing the situation in which the total drafts drawn do total more than the maximum amount of the credit.

2. The entire purpose of the usual letter of credit transaction, from the customer's point of view, is to induce the beneficiary to deliver to him through the issuer the documents described in the credit. The buying customer wants the goods, and arranges the transaction in order to get the documents controlling the goods.

Therefore, upon honor of the draft, the documents must be delivered free of claims even though the letter of credit is not for the full invoice price and any reservation of claim makes the draft non-complying. A beneficiary who wishes to prevent such delivery must do so by agreement with the customer in the underlying contract and must treat the failure to provide a sufficient letter of credit as a breach of that contract (Section 2—325). So far as the issuer's duty to honor is concerned, the terms of the letter of credit are controlling and the rule of subsection (2) is applicable.

**Cross references:**

Point 1: Section 5—108.

Point 2: Sections 2—325, 5—114.

**Definitional cross references:**

"Beneficiary". Section 5—103.

"Credit". Section 5—103.

"Documentary draft". Section 5—103.

"Document". Section 5—103.

"Draft". Section 3—104.

"Honor". Section 1—201.

"Person". Section 1—201.

### NORTH CAROLINA COMMENT

"Presenter" is defined in GS 25-5-112 (3). See also GS 25-5-108 (3) for rule gov-

erning situation when the total of drafts drawn exceeds the maximum credit.

§ 25-5-111. **Warranties on transfer and presentment.**—(1) Unless otherwise agreed the beneficiary by transferring or presenting a documentary draft or demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with. This is in addition to any warranties arising under articles 3, 4, 7 and 8.

(2) Unless otherwise agreed a negotiating, advising, confirming, collecting or issuing bank presenting or transferring a draft or demand for payment under a credit warrants only the matters warranted by a collecting bank under article 4 and any such bank transferring a document warrants only the matters warranted by an intermediary under articles 7 and 8. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purpose:**

The purpose of this section is to state the peculiar warranty of performance made by a beneficiary and to make clear the intermediary character of the persons moving the documents from the beneficiary to the customer. The beneficiary's warranty of compliance with the conditions of the credit in subsection (1) is expressly extended to all interested parties unless agreed to the contrary. So far as the draft or the relevant documents are concerned, the beneficiary's warranties are usually those of an ordinary transferor or indorser for value although varying circumstances may alter this. The usual warranties of an intermediary, listed in sub-

section (2), are primarily its own good faith and authority. See also Comment to Section 5—114(2).

**Cross references:**

Sections 3—417, 4—207, 7—507, 7—508, 8—306.

**Definitional cross references:**

"Advising bank". Section 5—103.

"Bank". Section 1—201.

"Beneficiary". Section 5—103.

"Collecting bank". Section 4—105.

"Confirming bank". Section 5—103.

"Credit". Section 5—103.

"Documentary draft". Section 5—103.

"Draft". Section 3—104.

"Party". Section 1—201.

#### NORTH CAROLINA COMMENT

Note under subsection (1) that the special warranty of a beneficiary ("that the necessary conditions of the credit have

been complied with") is in addition to the several warranties arising under: GS 25-3-417, 25-4-207, 25-7-507, 25-7-508, 25-8-306.

§ 25-5-112. **Time allowed for honor or rejection; withholding honor or rejection by consent; "presenter."**—(1) A bank to which a documentary draft or demand for payment is presented under a credit may without dishonor of the draft, demand or credit

(a) defer honor until the close of the third banking day following receipt of the documents; and

(b) further defer honor if the presenter has expressly or impliedly consented thereto.

Failure to honor within the time here specified constitutes dishonor of the draft or demand and of the credit.

(2) Upon dishonor the bank may unless otherwise instructed fulfill its duty to return the draft or demand and the documents by holding them at the disposal of the presenter and sending him an advice to that effect.

(3) "Presenter" means any person presenting a draft or demand for payment for honor under a credit even though that person is a confirming bank or other correspondent which is acting under an issuer's authorization. (1965, c. 700, s. 1.)

**Cross Reference.**—See Editor's note to § 25-5-114.

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. A bank called on to honor drafts under a credit must examine the accompanying documents with care. See Section 5—

109(2). That may take time. Subsection (1) of this section therefore allows a longer period than in the case of ordinary drafts (Section 3—506) for the decision. The language in the postamble to subsection



(1) particularizes for letters of credit the general rule on what constitutes dishonor for negotiable instruments (Section 3—507) and makes it clear that not only the draft but the credit is dishonored. If the particular draft is for a portion of the credit only, its wrongful dishonor is anticipatory repudiation of the entire credit and the beneficiary may proceed under Section 5—115(2) as well as 5—115(1).

2. Many letters of credit involve transactions in international trade and include as required documents the documents of title controlling the possession of goods on their way to the place of issuance of the credit. The ordinary rule requiring physical return of dishonored documentary drafts (Section 4—302) would therefore frequently work commercial hardship on the mercantile parties to the transaction; resale of the goods might be more difficult if the controlling documents of title were not available at the place of arrival of the goods. Subsection (2) therefore expressly permits the issuer to retain the documents as bailee for the presenter if it advises the presenter of its retention for that purpose. Compare Sections 4—202(1) (b), 4—503 and 4—504 on the duties of presenting banks.

#### NORTH CAROLINA COMMENT

The standard three-day time for a bank's determining whether to honor a documentary draft under a credit is longer than the time for ordinary drafts under GS 25-3-506, because the accompanying documents must be examined with great care.

Note in the postamble to subsection (1) that both the draft and the credit are dis-

3. The definition of "presenter" is to make clear that the term may include a bank which has rights in the documentary draft or which is in one sense the agent of the issuer. Such a bank may nevertheless give consent under subsection (1), and the advice authorized in subsection (2) may be sent to it.

4. Insofar as the banks involved may also be depositary, collecting or paying banks, Article 4 is applicable. Article 3 applies to the extent that a negotiable instrument is involved.

#### Cross references:

Point 1: Sections 3—506, 3—507, 5—109, 5—114 and 5—115.

Point 2: Sections 4—202, 4—302, 4—503 and 4—504.

Point 4: Articles 3 and 4.

#### Definitional cross references:

"Bank". Section 1—201.

"Confirming bank". Section 5—103.

"Credit". Section 5—103.

"Documentary draft". Section 5—103.

"Draft". Section 3—104.

"Honor". Section 1—201.

"Issuer". Section 5—103.

"Send". Section 1—201.

honored upon failure to act within the specified time.

Subsection (2), permitting the bank to retain documents as bailee for the presentee, may be compared with the general duty of presenting banks under GS 25-4-202 (1) (b), 25-4-503 and 25-4-504.

**§ 25-5-113. Indemnities.**—(1) A bank seeking to obtain (whether for itself or another) honor, negotiation or reimbursement under a credit may give an indemnity to induce such honor, negotiation or reimbursement.

(2) An indemnity agreement inducing honor, negotiation or reimbursement

(a) unless otherwise explicitly agreed applies to defects in the documents but not in the goods; and

(b) unless a longer time is explicitly agreed expires at the end of ten business days following receipt of the documents by the ultimate customer unless notice of objection is sent before such expiration date. The ultimate customer may send notice of objection to the person from whom he received the documents and any bank receiving such notice is under a duty to send notice to its transferor before its midnight deadline. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. A draft and accompanying documents may almost comply with the terms of the credit, but fail in some particular. The issuer is then not obligated to honor the draft, but it may be willing to do so if properly indemnified against the particular

defect. Subsection (1) makes clear that it is proper for a bank seeking payment, acceptance, negotiation or reimbursement under the credit to give such indemnities, and that doing so is a proper part of the business of banking and therefore not ultra vires.

2. Subsection (2) (a) limits the agreed

indemnity to defects in the documents, since under Section 5—109(1) (a) the issuer is ordinarily not responsible for performance of the underlying transaction. The parties are free to agree further on the scope of the indemnity, but the agreement must be explicit, since an indemnity against defects in the goods would be most unusual.

3. Subsection (2) (b) makes it clear that the indemnity in the absence of explicit agreement for a longer time continues for ten days after the receipt of the document by the ultimate customer, i.e., the customer who is a party to the underlying transaction. This ten day period may not be shortened. If the customer fails to send notice of objection within the period, he loses his right to object and the need for the indemnity disappears. Compare Section 2—605(2). Thus indemnitors are free of the possibility of unknown long-continuing contingent liability, a danger under existing law.

4. The question whether a particular banking usage may require honor of docu-

mentary drafts accompanied by indemnities for particular defects goes to the meaning of the terms of the credit and is beyond the scope of this section. See, e.g., *Dixon, Irmaos & Cia, Ltda., v. Chase Nat. Bank of City of New York*, 144 F.2d 759 (2d Cir., 1944). If by virtue of indemnities and usage the credit is complied with, the rights of the customer rest on the implications of the usage rather than on breach of the issuer's duty under this Article. Even so, the policy of this section and its terms require notice before the expiration date.

#### Cross references:

Point 2: Section 5—109.

Point 3: Section 2—605.

Point 4: Section 1—205.

#### Definitional cross references:

"Bank". Section 1—201.

"Credit". Section 5—103.

"Customer". Section 5—103.

"Documents". Section 5—103.

"Honor". Section 1—201.

"Midnight deadline" Section 4—104.

"Person". Section 1—201.

"Send". Section 1—201.

### NORTH CAROLINA COMMENT

A bank will not be acting *ultra vires* when it gives an indemnity under subsection (1).

Subsection (2) (a) limits the indemnity to defects in the *documents* and not to defects in the goods.

Under subsection (2) (b) the indemnity period may not be less than ten days after receipt by the ultimate customer (i.e., the

customer who is a party to the underlying transaction). If the customer fails to send notice of any objection within the ten days (or longer agreed period), he loses his right to object, and the need for indemnity disappears. Cf. GS 25-2-605 (2) (waiver of buyer's objection by failure to particularize).

**§ 25-5-114. Issuer's duty and privilege to honor; right to reimbursement.**—(1) An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honor of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specified documents must be satisfactory to it.

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (§ 25-7-507) or of a security (§ 25-8-306) or is forged or fraudulent or there is fraud in the transaction

(a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (§ 25-3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (§ 25-7-502) or a bona fide purchaser of a security (§ 25-8-302); and

(b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

(3) Unless otherwise agreed an issuer which has duly honored a draft or demand for payment is entitled to immediate reimbursement of any payment made under the credit and to be put in effectively available funds not later than the day before maturity of any acceptance made under the credit. (1965, c. 700, s. 1.)

**Editor's Note.**—Optional subsections (4) and (5), discussed in Official Comment 4 below, were not adopted, and for that reason optional language making an exception

of the provisions of subsection (4) was also omitted at the end of subsection (1) of § 25-5-112.

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

To define the areas in which the issuer must honor drafts or demands for payment under a credit and those in which he has an option to do so and to make explicit the customer's duty of reimbursement.

1. The letter of credit is essentially a contract between the issuer and the beneficiary and is recognized by this Article as independent of the underlying contract between the customer and the beneficiary (See Section 5—109 and Comment thereto). In view of this independent nature of the letter of credit engagement, the issuer is under a duty to honor the drafts or demands for payment which in fact comply with the terms of the credit without reference to their compliance with the terms of the underlying contract. This is stated in subsection (1). Attempts by the issuer to reserve a right to dishonor by including a clause that all documents must be satisfactory to itself are declared invalid as essentially repugnant to an irrevocable letter of credit. Such a reservation can be made by issuing a revocable credit. See Section 5—106. Particular documents, such as bills of lading or inspection or weight certificates can, of course, be required to be satisfactory to the issuer. The duty of the issuer to honor where there is factual compliance with the terms of the credit is also independent of any instructions from its customer once the credit has been issued and received by the beneficiary. See Section 5—106.

2. Documents, however, may appear regular on their face and apparently conforming to the credit whereas in fact they are forged or fraudulent or in other respects non-conforming to the warranties which arise under other Articles of the Code on their transfer or negotiation. Since the issuer's duties to its customer are limited to examination of the documents with care (Section 5—109) and since it is important to preserve both the independent character of the issuer's engagement and the reasonable reliance on that engagement of persons dealing with papers regular on their face and in apparent compliance with the terms of the credit, subsection (2) (a)

includes as an area in which the issuer's duty to honor exists cases in which persons have acted in a manner which would make them the equivalent of holders in due course under Article 3 or, where relevant, persons to whom documents have been duly negotiated under Article 7 or bona fide purchasers of securities under Article 8. The risk of the original bad-faith action of the beneficiary is thus thrown upon the customer who selected him rather than upon innocent third parties or the issuer. So, too, is the risk of fraud in the transaction placed upon the customer.

When, however, no innocent third parties as defined in subsection (a) are involved the issuer is no longer under a duty to honor; but since these matters frequently involve situations in which the determination of the fact of the non-conformance may be difficult or time-consuming, the issuer if he acts in good faith is given the privilege of honoring the draft as against its customer, that is to say, with a right of reimbursement against him. The issuer may, however, refuse honor. In the event of honor, an action by the customer against the beneficiary will lie by virtue of either the underlying contract or Section 5—111(1) of this Article. In the event of dishonor, if the presenter is a person who has parted with value, he also may recover against the beneficiary under Section 5—111(1).

3. Subsection (3) represents the standard form for reimbursement. The words "duly honored" include not only situations where the issuer has honored because it was his duty to do so but also where he was privileged to do so as in subsection (2) (b) or has done so as under Section 5—106(4).

4. Optional subsections (4) and (5) are for the purpose of clarifying a situation which has arisen under the currency restrictions of a few nations and in which payment is required to be made under the credit before opportunity exists to examine the documents. The Article resolves this situation by making clear that the payment is conditional in nature and may be re-



versed by subsequent timely discovery of defects in the documents.

**Cross references:**

Point 1: Sections 5—106 and 5—109.

Point 2: Sections 5—106, 5—109, 5—111 and Articles 3, 7 and 8.

Point 3: Section 5—106.

**Definitional cross references:**

"Bank". Section 1—201.

"Beneficiary". Section 5—103.

"Contract". Section 1—201.

"Contract for sale". Section 2—106.

"Credit". Section 5—103.

"Customer". Section 5—103.

"Document". Section 5—103.

"Document of title". Section 1—201.

"Draft". Section 3—104.

"Good faith". Section 1—201.

"Holder". Section 1—201.

"Honor". Section 1—201.

"Issuer". Section 5—103.

"Notification". Section 1—201.

"Receives notice". Section 1—201.

"Security". Section 8—102.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* Since a credit is essentially a contract between the issuer and the beneficiary (see GS 25-5-109), the issuer is legally bound to honor drafts which comply with the terms of the credit, even

though the documents do not comply with the underlying independent contract between the customer and the beneficiary.

*Subsection (2) (a)* protects innocent purchasers for value of drafts.

**§ 25-5-115. Remedy for improper dishonor or anticipatory repudiation.**—(1) When an issuer wrongfully dishonors a draft or demand for payment presented under a credit the person entitled to honor has with respect to any documents the rights of a person in the position of a seller (§ 25-2-707) and may recover from the issuer the face amount of the draft or demand together with incidental damages under § 25-2-710 on seller's incidental damages and interest but less any amount realized by resale or other use or disposition of the subject matter of the transaction. In the event no resale or other utilization is made the documents, goods or other subject matter involved in the transaction must be turned over to the issuer on payment of judgment.

(2) When an issuer wrongfully cancels or otherwise repudiates a credit before presentment of a draft or demand for payment drawn under it the beneficiary has the rights of a seller after anticipatory repudiation by the buyer under § 25-2-610 if he learns of the repudiation in time reasonably to avoid procurement of the required documents. Otherwise the beneficiary has an immediate right of action for wrongful dishonor. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. Subsection (1) states the rights of a person entitled to honor, both with respect to any documents and against the issuer, when there is wrongful dishonor. Whether dishonor is wrongful and whether a particular person is entitled to honor depend on the terms of the credit and on the provisions of this Article, particularly Section 5—114 on the issuer's duty to honor and Section 5—116 on transfer and assignment.

2. Subsection (2) states the rights of the beneficiary upon repudiation of the credit, both against the issuer and with respect to any documents or goods. Note that wrongful dishonor of a draft for a portion of the credit is dishonor of the credit under Section 5—112(1), and makes applicable subsection (2) of this section as well as subsection (1).

3. Both subsections are limited to irrevocable credits. Since under Section 5—106

(3) revocable credits may be modified or revoked without notice to the customer or the beneficiary, rights against the issuer like those here provided can hardly arise under them. The rights of innocent third persons under revocable credits are governed by Section 5—106(4) rather than by this section.

**Cross references:**

Point 1: Sections 2—707, 2—710, 5—114 and 5—116.

Point 2: Sections 2—610, 2—611, 2—703 through 2—706, and 5—112.

Point 3: Section 5—106.

**Definitional cross references:**

"Action". Section 1—201.

"Beneficiary." Section 5—103.

"Credit". Section 5—103.

"Document". Section 5—103.

"Draft". Section 3—104.

"Issuer". Section 5—103.

"Person". Section 1—201.

"Rights". Section 1—201.

## NORTH CAROLINA COMMENT

This is an important section, and the following summarization of the Official Comment will describe its purposes.

*Subsection (1)* states the rights of the person entitled to honor, both with respect to (1) rights to documents and (2) rights to hold the issuer for dishonor. Whether there has been a wrongful dishonor is determined by other sections of article 5, especially GS 25-5-114 on issuer's duty to honor and GS 25-5-116 on transfer and assignment.

*Subsection (2)* states the rights of the

beneficiary upon repudiation of the credit both with respect to (1) rights against documents and (2) rights against the issuer.

Both subsections are limited to irrevocable credits. Under GS 25-5-106 (3) revocable credits may be modified or revoked without notice to the customer or the beneficiary. The rights of innocent third persons under revocable credits are covered by GS 25-5-106 (4) rather than by this section.

**§ 25-5-116. Transfer and assignment.**—(1) The right to draw under a credit can be transferred or assigned only when the credit is expressly designated as transferable or assignable.

(2) Even though the credit specifically states that it is nontransferable or nonassignable the beneficiary may before performance of the conditions of the credit assign his right to proceeds. Such an assignment is an assignment of a contract right under article 9 on secured transactions and is governed by that article except that

(a) the assignment is ineffective until the letter of credit or advice of credit is delivered to the assignee which delivery constitutes perfection of the security interest under article 9; and

(b) the issuer may honor drafts or demands for payment drawn under the credit until it receives a notification of the assignment signed by the beneficiary which reasonably identifies the credit involved in the assignment and contains a request to pay the assignee; and

(c) after what reasonably appears to be such a notification has been received the issuer may without dishonor refuse to accept or pay even to a person otherwise entitled to honor until the letter of credit or advice of credit is exhibited to the issuer.

(3) Except where the beneficiary has effectively assigned his right to draw or his right to proceeds, nothing in this section limits his right to transfer or negotiate drafts or demands drawn under the credit. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None  
**Purposes:**

1. The situation involved is typified by that of an exporter who has made a contract for sale with a foreign buyer and is beneficiary of a letter of credit initiated by the buyer, especially where the subject matter involves goods still to be manufactured. The exporter is frequently in need of the wherewithal not only to finance payment to his supplier but to assure the latter against cancellation of the order during the process of manufacture. For this purpose assignment of the exporter's rights under the letter of credit is frequently desirable.

Since, however, there is general confusion of thought as to the meaning of "assignment or transfer of a credit," the law remains uncertain. If "assignment of the credit" includes delegation of performance of the conditions under the credit then the initiating customer, who in many cases

has put his faith in performance or supervision of performance by a beneficiary of established reputation, may be deprived of real and intended security. See Comment to Section 2—210 on the comparable situation as to the sales contract. On the other hand, all "negotiation credits" involve a transfer of the rights of the beneficiary by way of negotiation of the draft and such transfer involves no important loss of the initiating party's intended safety. Meanwhile, the exceedingly useful institution of "back to back" credits, in which an American bank issues a credit with the exporter as the initiating customer and the exporter's supplier as the beneficiary is dangerous for the banker unless he can secure in advance an effective assignment from the exporter of the latter's rights under the initial credit issued on behalf of his foreign buyer. Against this background, the section is drawn.

2. Subsection (1) requires the benefi-

ciary's signature on drafts drawn under the credit unless it is expressly designated as assignable or transferable. If it is so designated, the normal rules of assignment apply and both the right to draw and the performance of the beneficiary can be transferred, subject to the beneficiary's continuing liability, if any, for the nature of the performance.

3. Subsection (2) makes clear that to safeguard among other things the letter of credit "back to back" practice, the assignability of proceeds in advance of performance cannot be prohibited in advance of performance. In this respect the letter of credit is treated like any other contract calling for money to be earned. See Section 9—318 generally and Section 2—210 as to sales contracts. But the special nature of the letter of credit as evidence of the right to proceeds is recognized by the additional requirement of delivery of the letter to the assignee as a condition precedent to the perfection of the assignment. Similarly, the fact that letters of credit normally require presentation of drafts or demands for payment which are drawn un-

der it and that as a result notice of assignment of proceeds can exist simultaneously with a draft payable by order or indorsement to either the beneficiary or another third person leads to the necessity for permitting an issuer to protect itself against double payment by requiring exhibition of the letter or advice of credit.

4. Subsection (3) makes clear that the section has no application to the normal case of negotiation of a draft or the transfer of a demand for payment unless effective assignment under the section has taken place.

#### Cross references:

Point 1: Section 2—210.

Point 3: Sections 2—210 and 9—318 and Article 9.

#### Definitional cross references:

"Accept". Section 3—410.

"Beneficiary". Section 5—103.

"Contract right". Section 9—106.

"Credit". Section 5—103.

"Draft". Section 3—104.

"Honor". Section 1—201.

"Issuer". Section 5—103.

"Receive notification". Section 1—201.

### NORTH CAROLINA COMMENT

Subsections (1) and (2) generally do not permit an assignment of the beneficiary's right to draw, but they do permit a beneficiary to assign his rights to proceeds. A proper assignment of proceeds is governed by the rules of assignment of a contract right under article 9 with the exceptions stated in subsection (2).

This section is made necessary by gen-

eral confusion as to when there can be a transfer or assignment of a credit.

Subsection (3) makes it clear that the section has no application to the normal case of negotiation of a draft or the transfer of a demand for payment unless there has been an effective assignment of the credit under this section.

**§ 25-5-117. Insolvency of bank holding funds for documentary credit.**—(1) Where an issuer or an advising or confirming bank or a bank which has for a customer procured issuance of a credit by another bank becomes insolvent before final payment under the credit and the credit is one to which this article is made applicable by paragraphs (a) or (b) of § 25-5-102 (1) on scope, the receipt or allocation of funds or collateral to secure or meet obligations under the credit shall have the following results:

(a) to the extent of any funds or collateral turned over after or before the insolvency as indemnity against or specifically for the purpose of payment of drafts or demands for payment drawn under the designated credit, the drafts or demands are entitled to payment in preference over depositors or other general creditors of the issuer or bank; and

(b) on expiration of the credit or surrender of the beneficiary's rights under it unused any person who has given such funds or collateral is similarly entitled to return thereof; and

(c) a change [charge] to a general or current account with a bank if specifically consented to for the purpose of indemnity against or payment of drafts or demands for payment drawn under the designated credit falls under the same rules as if the funds had been drawn out in cash and then turned over with specific instructions.

(2) After honor or reimbursement under this section the customer or other person for whose account the insolvent bank has acted is entitled to receive the documents involved. (1965, c. 700, s. 1.)



**Editor's Note.**—The word “charge” in brackets in paragraph (c) of subsection (1) is suggested as a correction of

“change,” which appears in the 1965 Session Laws.

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

A bank which issues a letter of credit acts as a principal, not as agent for its customer, and engages its own credit. But the resulting liability is not like that to its depositors, and the security and indemnity furnished by the customer against it and the documents which it receives on honor of complying drafts are not like its own investments.

The typical letter of credit transaction facilitates the movement of goods. The bank's credit is engaged, but it expects to be put in funds by its customer before it makes disbursements, or to be reimbursed immediately afterwards. And everybody understands that the documents received upon honor of complying drafts are to be turned over to the customer at once when he makes reimbursement or signs trust receipts. Only the bank's commission, if the transaction is completed, will enter the bank's general assets and join the other backing of its deposit liabilities.

It is therefore proper, when insolvency occurs before the letter of credit transaction is completed, to regard both the outstanding liabilities, the security held and funds provided to indemnify against those liabilities, and the related drafts and docu-

ments, as separate from deposit liabilities and from general assets, and to deal with them as separate. To do so carries out the original purpose, which is to facilitate the underlying mercantile transaction, and does no wrong to the bank's depositors and other general creditors.

This section states appropriate rules to carry out these principles. The section is limited to transactions under Section 5—102(1) (a) and (b) to prevent abuse in situations where the commercial purpose of facilitating the movement of goods, securities or the like may be lacking.

**Cross reference:**

Compare Section 4—214, and the Comment thereto.

**Definitional cross references:**

“Advising Bank”. Section 5—103.

“Bank”. Section 1—201.

“Beneficiary”. Section 5—103.

“Confirming Bank”. Section 5—103.

“Credit” Section 5—103.

“Customer”. Section 5—103.

“Document”. Section 5—103.

“Draft” Section 3—104.

“Honor”. Section 1—201.

“Insolvent”. Section 1—201.

“Issuer”. Section 5—103.

“Person”. Section 1—201.

### NORTH CAROLINA COMMENT

This section regards the outstanding liabilities, the security held and funds provided to indemnify those liabilities, and the related drafts and documents, as separate from deposit liabilities and from general

assets. To do so facilitates the underlying mercantile transaction, and does no wrong to the bank's depositors and other general creditors.

### ARTICLE 6.

#### *Bulk Transfers.*

**§ 25-6-101. Short title.**—This article shall be known and may be cited as Uniform Commercial Code—Bulk Transfers. (1965, c. 700, s. 1.)

**Cross References.**—As to power of corporation to sell, transfer and convey all or part of its property, see § 55-17 (b) (2). As to assignments for benefit of creditors, see § 23-1 et seq.

**The former Bulk Sales Law, § 39-23, was not unconstitutional** or void as an unwarranted limitation of the right to sell and dispose of property. *Pender v. Speight*, 159 N.C. 612, 75 S.E. 851 (1912).

**It Was Valid Exercise of Police Power.**—Section 39-23, now repealed, was a valid

exercise of the police powers of government, and thereunder a bulk sale was to be regarded as prima facie fraudulent in the trial of an issue as to its validity. *Pennell v. Robinson*, 164 N.C. 257, 80 S.E. 417 (1913); *Gallup & Co. v. Rozier*, 172 N.C. 283, 90 S.E. 209 (1916); *Whitmore-Ligon Co. v. Hyatt*, 175 N.C. 117, 95 S.E. 38 (1918); *Raleigh Tire & Rubber Co. v. Morris*, 181 N.C. 184, 106 S.E. 562 (1921).

**Strict Construction.**—A statute making void as against creditors a sale of a large

part or the whole of a stock of merchandise in bulk, unless the requirements of the act are complied with, is in derogation of the common law, and must be strictly construed. *Swift & Co. v. Tempelos*, 178 N.C. 487, 101 S.E. 8 (1919).

#### Vendor's Right to Personal Property

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. This Article attempts to simplify and make uniform the bulk sales law of the states that adopt this Act.

2. Many states have bulk sales laws, of varying type and coverage. Their central purpose is to deal with two common forms of commercial fraud, namely.

(a) The merchant, owing debts, who sells out his stock in trade to a friend for less than it is worth, pays his creditors less than he owes them, and hopes to come back into the business through the back door some time in the future.

(b) The merchant, owing debts, who sells out his stock in trade to any one for any price, pockets the proceeds, and disappears leaving his creditors unpaid.

3. The first is one form of fraudulent conveyance. The substantive law concerning it has been codified by the Commissioners in the Uniform Fraudulent Conveyance Act. No change in that Act is proposed. The contribution of the bulk sales laws to the problem is in the requirement that creditors receive advance notice of bulk sales. Having such notice, they can investigate the price and other circumstances of the sale before it occurs, and determine then instead of later whether they should try to stop it. This is a valuable policing measure, and is continued. To be effective, it requires a longer notice than five days. This Article therefore follows in this respect those laws which require a longer notice (Sections 6—105, 6—108).

4. The second form of fraud suggested above represents the major bulk sales risk,

**Exemption.**—The vendor in a sale of merchandise in bulk which is void under the Bulk Sales Law was not deprived of his right to his personal property exemption under execution of his judgment creditor. *Whitmore-Ligon Co. v. Hyatt*, 175 N.C. 117, 95 S.E. 38 (1918).

and its prevention is the central purpose of the existing bulk sales laws and of this Article. Advance notice to the seller's creditors of the impending sale is an important protection against it, since with notice the creditors can take steps to impound the proceeds if they think it necessary. In many states, typified for instance by New York, such notice is substantially the only protection which bulk sales statutes give. Other states, typified for instance by Pennsylvania, give additional protection by imposing on the buyer an obligation to ensure that the money that he pays to his indebted seller is in fact applied to pay the seller's debts. This Article requires notice to creditors (Section 6—105) and if bracketed Section 6—106 is enacted it imposes the other obligation also.

5. These are the affirmative reasons for a law such as this Article. The objections are chiefly delay and red tape on legitimate transactions, and the possibility of a trap for the unwary buyer. It is hard to avoid the latter danger. But to minimize both it and the former the transactions subject to the Article are identified as clearly as possible and are limited to those which carry the dangers to be guarded against (Sections 6—102 and 6—103), and the sanctions are such as to permit honest and solvent buyers and sellers to put through transactions promptly without undue risk. Sections 6—104 through 6—108.

#### Cross references:

Point 3: Sections 6—105 and 6—108.

Point 4: Sections 6—105 and 6—106.

Point 5: Sections 6—102, 6—103, 6—104 through 6—108.

**§ 25-6-102. "Bulk transfers"; transfers of equipment; enterprises subject to this article; bulk transfers subject to this article.**—(1) A "bulk transfer" is any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the materials, supplies, merchandise or other inventory (§ 25-9-109) of an enterprise subject to this article.

(2) A transfer of a substantial part of the equipment (§ 25-9-109) of such an enterprise is a bulk transfer if it is made in connection with a bulk transfer of inventory, but not otherwise.

(3) The enterprises subject to this article are all those whose principal business is the sale of merchandise from stock, including those who manufacture what they sell.

(4) Except as limited by the following section [§ 25-6-103] all bulk transfers of

goods located within this State are subject to this article. (1907, c. 623; 1913, c. 30, s. 1; Ex. Sess. 1913, c. 66, s. 1; C. S., s. 1013; 1933, c. 190; 1945, c. 635; 1963, c. 1179; 1965, c. 700, s. 1.)

**Business of Purchaser Is Immaterial.**—Where a dealer in automobile supplies has sold his stock of merchandise in bulk to those whose business it is to use such material in making repairs for their customers, the purchasers may not avoid liability to the creditors of the vendor on the ground that they were not dealers in such

wares under the doctrine announced in *Swift & Co. v. Tempelos*, 178 N.C. 487, 101 S.E. 8 (1919), for the question is not what the purchaser has done, or proposed to do, with the goods, but what was the business of the vendor who sold them. *Raleigh Tire & Rubber Co. v. Morris*, 181 N.C. 184, 106 S.E. 562 (1921).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. Much of the litigation under the existing laws has dealt with the kinds of businesses and the kinds of transfers covered. This section defines these matters.

2. The businesses covered are defined in subsection (3). Notice that they do not include farming nor contracting nor professional services, nor such things as cleaning shops, barber shops, pool halls, hotels, restaurants, and the like whose principal business is the sale not of merchandise but of services. While some bulk sales risk exists in the excluded businesses, they have in common the fact that unsecured credit is not commonly extended on the faith of a stock of merchandise.

3. The transfers included are of "materials, supplies, merchandise or other inventory" that is, of goods. Transfers of investment securities are not covered by the Article, nor are transfers of money, accounts receivable, chattel paper, contract rights, negotiable instruments, nor things in action generally. Such transfers are dealt with in other Articles, and are not believed to carry any major bulk sales risk.

4. The kinds of transfers covered are identified in paragraph (1). They are believed to be those that carry the major bulk sales risks. They are further limited by the section following.

#### Cross references:

Point 3: Articles 3, 4, 8 and 9.

Point 4: Section 6—103.

#### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection seems to be substantially the same as the prior law of North Carolina. The prior North Carolina statute used the description "large part or the whole of a stock of merchandise" rather than the UCC description of a "major part of the materials, supplies, merchandise or other inventory." See *Armfield Co. v. Saleeby*, 178 N.C. 298, 100 S.E. 611 (1919), where the court says that the sale of ten per cent of the value of a stock of goods was not a large enough part thereof to make the Bulk Sales Law applicable. It seems that "major part" is thought to mean more than half. See 1952 Wis. L. Rev. 312. Thus, the UCC may be slightly narrower than the prior North Carolina law. The language "in bulk and not in the ordinary course of the transferor's business" seems to be parallel to the meaning of the prior law. The prior law applied to "a stock of merchandise, in the sense of a stock of goods which have been bought for resale in a substantially unchanged condition . . ." *Swift & Co. v. Tempelos*, 178 N.C. 487, 101 S.E. 8 (1919). This meaning may be narrower than the UCC above.

*Subsection (2):* This subsection may

make a change in the prior law, for it was not clear that "equipment" was included in the meaning of "stock of merchandise." But see *Swift & Co. v. Tempelos*, 178 N.C. 487, 101 S.E. 8 (1919), where the court in dicta says, "As to the furniture and fixtures used in the business of the keeper of the cafe, they are not kept for sale, and are not within the provisions of the statute. Now, if this stock itself is within it, so as to be, in fact, a 'clean-up' sale of the whole business, the appellee's position might, perhaps, be correct, but we do not decide, or intimate any opinion as to such a question." The court seems to have reserved the very point covered by this subsection.

*Subsection (3):* This subsection may broaden the coverage of the prior law. The cases generally hold that bulk sales laws relating to sales of merchandise have no application to sales by manufacturers, though there is a slight tendency in recent cases to cover some sales of stock by manufacturers. See 168 ALR 735, 742 and the discussion in *Swift & Co. v. Tempelos*, 178 N.C. 487, 101 S.E. 8 (1919).

*Subsection (4):* This is new in North Carolina, though the North Carolina law probably applied to all sales in bulk in the



State. There is nothing on the problem of whether, in determining whether a "major part" of the covered goods has been trans-

ferred under subsection (1), there must be taken into account similar goods of the transferor located outside the State.

**§ 25-6-103. Transfers excepted from this article.** — The following transfers are not subject to this article:

- (1) Those made to give security for the performance of an obligation;
- (2) General assignments for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder;
- (3) Transfers in settlement or realization of a lien or other security interest;
- (4) Sales by executors, administrators, receivers, trustees in bankruptcy, or any public officer under judicial process;
- (5) Sales made in the course of judicial or administrative proceedings for the dissolution or reorganization of a corporation and of which notice is sent to the creditors of the corporation pursuant to order of the court or administrative agency;
- (6) Transfers to a person maintaining a known place of business in this State who becomes bound to pay the debts of the transferor in full and gives public notice of that fact, and who is solvent after becoming so bound;
- (7) A transfer to a new business enterprise organized to take over and continue the business, if public notice of the transaction is given and the new enterprise assumes the debts of the transferor and he receives nothing from the transaction except an interest in the new enterprise junior to the claims of creditors;
- (8) Transfers of property which is exempt from execution.

Public notice under subsection (6) or subsection (7) may be given by publishing once a week for two consecutive weeks in a newspaper of general circulation where the transferor had its principal place of business in this State an advertisement including the names and addresses of the transferor and transferee and the effective date of the transfer. (1907, c. 623; 1913, c. 30, s. 1; Ex. Sess. 1913, c. 66, s. 1; C. S., s. 1013; 1933, c. 190; 1945, c. 635; 1963, c. 1179; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. The section defines the transfers which although within the general definition of the previous section ought not to be subjected to the requirements of this Article.

2. Some of the existing Bulk Sales laws cover "bulk mortgages" as well as outright sales. In this Code security interests of all kinds in personal property are regulated by Article 9, Secured Transactions. Subsection (1) of this section therefore excludes all transfers for security from the operation of this Article. See also Sec. 9—111.

3. The exclusions described in subsections (2), (3), (4), (5) and (8) are believed to explain themselves.

4 Subsection (6) will exclude a great many transactions from the requirements of this Article. It is believed the exclusion is justified, and that it removes many of the objections to a law of this character. The transactions excluded are outright sales, since that is the only kind of a transaction in which the transferee is likely to bind himself to pay the transferor's debts. The purpose of this Article on outright

sales is to give the seller's creditors a reasonable chance to collect their debts. (See Sections 6—104 through 6—108). If the buyer is willing to assume personal liability for those debts, and is himself solvent after such assumption, there is no reason to subject the transaction to the delay and red tape which this Article imposes.

5. Subsection (7) deals with certain changes in the ownership of a business, as by incorporation, change of membership of a firm, or transfer from a sole proprietor to a firm. The exclusion is believed to be justified within the limits stated in the subsection. Notice that in all the transactions to which the subsection applies (a) both the original debtor and the new enterprise are personally bound to pay the debts, (b) the property subject to the debts before the transfer is still subject to them, and (c) the original debtor has taken nothing out of the transaction except an interest (shares in a corporation, an interest in a firm, or a subordinated obligation) which is junior to the debts.

#### Cross references:

Point 1: Section 6—102.

Point 2: Section 9—111 and Article 9 generally.

Point 4: Sections 6—104 through 6—108.

#### Definitional cross references:

"Creditor". Sections 1—201 and 6—109.

"Person". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection seems to be similar to prior law. In *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960), lender was assigned conditional sales contracts as security for financing goods in seller's store. Eventually lender took out of seller's store and stored in a warehouse a large part of the stock of the seller. The court said, "Under our decisions the trust receipts given by Crawford cannot be deemed violative of GS 39-23 or void as against creditors, because the debts secured by the trust receipts were not preexistent but contemporaneous with the contract of purchase from intervenor, constituting a part of one continuous transaction." The chattel mortgage had not been filed in this case. Note also: The court has held that where a person, who is insolvent, makes an assignment of practically all his property to secure a preexisting debt, there being also other creditors, such instrument will be treated as an assignment for the benefit of creditors and subject to the statutes relating thereto, and neither the omission of a small part of the debtor's property nor a defeasance clause in the instrument will change this result. See *National Bank v. Gilmer*, 116 N.C. 684, 22 S.E. 2 (1895).

*Subsection (2):* This subsection is in accord with the prior law which provided, "Nothing in this section shall prevent voluntary assignments or deeds of trust for the benefit of creditors as now allowed by law . . ." GS 39-23.

*Subsection (3):* This subsection seems to be in accord with the prior law. A chattel mortgage on a stock of goods, securing the purchase price, cannot be deemed an assignment for the benefit of creditors where the secured debt is contemporaneous with the contract of purchase, as a part of one continuous transaction. *Cowan v. Dale*, 189 N.C. 684, 128 S.E. 155 (1925). And see recent case, *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960).

But notice also that our court has held "that where a person who is insolvent makes an assignment of practically all his property to secure a preexisting debt, there being also other creditors, such instrument will be treated as an assignment for the benefit of creditors and subject to the statutes relating thereto, and that neither the

omission of a small part of the debtor's property nor a defeasance clause in the instrument will change this result." *Farmers' Banking & Trust Co. v. Tarboro Leaf Tobacco Co.*, 188 N.C. 177, 124 S.E. 158 (1924).

*Subsection (4):* This is the prior law. GS 39-23 provided that nothing in the Bulk Sales Statute should "apply to sales by executors, administrators, receivers or assignees under a voluntary assignment for the benefit of creditors, trustees in bankruptcy, or by any public officers under judicial process."

*Subsection (5):* This subsection is similar in principle in part to prior law, for the prior law excluded from the Bulk Sales Law "sales by any public officers under judicial process." Presumably the reason is the fact that the interest of creditors will be safeguarded by the judicial process, including sales by an administrative officer. There was no specific provision concerning dissolution or reorganization of a corporation in the prior Bulk Sales Law.

*Subsection (6):* This subsection is new. The theory behind this subsection is that if the transferee is willing to assume personal liability for all of the debts of the transferor, and is solvent after such assumption, there is no reason to subject the transaction to the delay and red tape which this article otherwise imposes. In a jurisdiction such as North Carolina where a third-party beneficiary may bring suit, there is no problem.

*Subsection (7):* This probably modifies the prior law. In *First Nat'l Bank v. Raleigh Sav. Bank & Trust Co.*, 37 F.2d 301 (4th Cir. 1930), the court held that a transfer of all goods of a business to a new corporation in return for stock of that corporation would violate the Bulk Sales Law.

*Subsection (8):* This subsection changes the prior law. The theory of cases dealing with this problem seemed to suggest that where one made a transfer that came under the Bulk Sales Law, the transfer was void, and that therefore the title to the goods remained in the transferor. This was held to be true even in the case of a transfer of exempt property. However, the debtor was still allowed his exemptions. See *Whitmore-Ligon Co. v. Hyatt*, 175 N.C. 117, 95 S.E. 38 (1918). In this case the court held that a vendor of merchandise in bulk which

was void under our statute was not deprived of his right to his personal property exemption under execution of his judgment creditor.

**§ 25-6-104. Schedule of property, list of creditors.**—(1) Except as provided with respect to auction sales (§ 25-6-108), a bulk transfer subject to this article is ineffective against any creditor of the transferor unless:

(a) The transferee requires the transferor to furnish a list of his existing creditors prepared as stated in this section; and

(b) The parties prepare a schedule of the property transferred sufficient to identify it; and

(c) The transferee preserves the list and schedule for six months next following the transfer and permits inspection of either or both and copying therefrom at all reasonable hours by any creditor of the transferor, or files the list and schedule in the office of the clerk of the superior court in the county where the transferor had its principal place of business in this State.

(2) The list of creditors must be signed and sworn to or affirmed by the transferor or his agent. It must contain the names and business addresses of all creditors of the transferor, with the amounts when known, and also the names of all persons who are known to the transferor to assert claims against him even though such claims are disputed. If the transferor is the obligor of an outstanding issue of bonds, debentures or the like as to which there is an indenture trustee, the list of creditors need include only the name and address of the indenture trustee and the aggregate outstanding principal amount of the issue.

(3) Responsibility for the completeness and accuracy of the list of creditors rests on the transferor, and the transfer is not rendered ineffective by errors or omissions therein unless the transferee is shown to have had knowledge. (1907, c. 623; 1913, c. 30, s. 1; Ex. Sess. 1913, c. 66, s. 1; C. S., s. 1013; 1933, c. 190; 1945, c. 635; 1963, c. 1179; 1965, c. 700, s. 1.)

**Compliance Is Question for Jury.** — In an action to set aside the sale of a stock of merchandise in bulk as void against creditors, it is for the jury to determine whether the seller had complied with the statutory requirement as to invoice, notice to creditors, etc., upon his evidence that he had done so, under proper instructions from the court; and a charge in effect that

if he had failed in this respect the transaction was *prima facie* fraudulent, and not that it was void, is reversible error. *Gallup & Co. v. Rozier*, 172 N.C. 283, 90 S.E. 209 (1916).

Evidence held to make out a case for the jury for violation of the Bulk Sales Law. *Kramer Bros. v. McPherson*, 245 N.C. 354, 95 S.E.2d 889 (1957).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. The section describes the information that must be compiled and kept available to creditors on all bulk transfers subject to this Article except those made by sale at auction. Additional requirements for particular kinds of transfers are stated in the succeeding Sections (6—105 through 6—107). The section on auction sales (Section 6—108) imposes similar requirements, but on different people and with a different sanction.

2. Except for the accuracy of the list of creditors, the sanction for non-compliance with the present section is that the transfer is ineffective against creditors of the transferor. The creditors referred to are those holding claims based on transactions or events occurring before the transfer (Section 6—109). Any such creditor or creditors may therefore disregard the

transfer and levy on the goods as still belonging to the transferor, or a receiver representing them can take them by whatever procedure the local law provides. But it follows also that if the debts of the transferor are paid as they mature disregard of the requirements of the section creates no liability. And a defect can always be cured by paying off the unpaid creditors.

3. The sanction for the accuracy of the list of creditors is the criminal law of the state relative to false swearing, made applicable by subsection (2).

#### Cross references:

Point 1: Sections 6—105 through 6—108.

Point 2: Section 6—109.

#### Definitional cross references:

"Bulk transfer". Section 6—102.

"Creditor". Sections 1—201 and 6—109.

"Party". Section 1—201.

"Person". Section 1—201.

"Signed". Section 1—201.



## NORTH CAROLINA COMMENT

*Subsection (1):* There seem to be no cases involving auction sales in North Carolina. There is conflict on this point in other states. See 65 Harv. L. Rev. 418 (1952).

The word "ineffective" used in the UCC may be interpreted to mean "voidable." It may thus be a little different from the prior law. The North Carolina court has said that a sale in bulk which does not comply with the Bulk Sales Law is "absolutely void as to creditors." *Pennell v. Robinson*, 164 N.C. 257, 80 S.E. 417 (1913).

(a) The prior law required the seller to "notify the creditors of the proposed sale." CS 39-23. Failure to notify made the sale void as to creditors.

(b) The prior law required that the seller make "an inventory showing the quantity and, so far as possible, the cost price to the seller of such articles included in the sale." This compares with the requirement of the UCC that the parties make a schedule of the property "sufficient to identify it."

(c) The prior law required the taking of an inventory and required that any claim had to be presented within twelve months. The statute did not specifically state anything about keeping the inventory or per-

mitting it to be examined, but to comply with the law it was necessary to keep the inventory available for twelve months. The UCC has the shorter, six months, period of limitations and the specific requirement that a creditor be permitted to inspect the list of creditors and the schedule of property.

*Subsection (2):* The prior law did not require that a list of creditors be signed and sworn to, but permitted a creditor, when a creditor had not been notified, to treat the transfer as void. See *Gallup & Co. v. Rozier*, 172 N.C. 283, 90 S.E. 209 (1916). There seem to be no cases indicating whether a person with a disputed claim had to be notified, but the UCC clears this doubt up.

*Subsection (3):* There was no provision in the prior law exactly like this, but the effect may be to change the law to some degree. This provision protects the purchaser even if the list of creditors is not accurate. Under the prior law, the failure to notify a creditor, even when the failure was inadvertent, permitted the transfer to be voided by the creditor omitted. *Gallup & Co. v. Rozier*, 172 N.C. 283, 90 S.E. 209 (1916).

**§ 25-6-105. Notice to creditors.**—In addition to the requirements of the preceding section [§ 25-6-104], any bulk transfer subject to this article except one made by auction sale (§ 25-6-108) is ineffective against any creditor of the transferor unless at least ten days before he takes possession of the goods or pays for them, whichever happens first, the transferee gives notice of the transfer in the manner and to the persons hereafter provided (§ 25-6-107). (1907, c. 623; 1913, c. 30, s. 1; Ex. Sess. 1913, c. 66, s. 1; C. S., s. 1013; 1933, c. 190; 1945, c. 635; 1963, c. 1179; 1965, c. 700, s. 1.)

**Purchaser Was Not Personally Liable.**—Under the provisions of former § 39-23 a creditor was entitled, at most, to have the transfer set aside, but not to hold the purchaser personally liable. *Goldman & Co. v. Chank*, 200 N.C. 384, 156 S.E. 919 (1931), discussing but not deciding whether sale was contrary to section. See *Raleigh Tire & Rubber Co. v. Morris*, 181 N.C. 184, 106 S.E. 562 (1921).

**Goods Could Be Reached or Purchaser Held for Their Value.**—When a sale of merchandise in bulk was avoided for non-compliance with the Bulk Sales Law, the

goods could be made available by direct process or levy and sale in the hands of the original purchaser, or such purchaser might be held liable for their value when they were disposed of by him, and either remedy was available to the creditors of the vendor against subsequent purchasers as long as the goods could be identified, or until they had passed into the hands of a bona fide purchaser for value without notice. *Raleigh Tire & Rubber Co. v. Morris*, 181 N.C. 184, 106 S.E. 562 (1921). See *Kramer Bros. v. McPherson*, 245 N.C. 354, 95 S.E.2d 889 (1957).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes.**

1. This section is the heart of the Article. It requires notice to creditors of all bulk transfers subject to the Article, except those made by auction sale. The con-

tents of the notice, the persons to whom it must be given, and the manner of giving it are stated in Section 6—107. The section on auction sales (6—108) also calls for notice, but by a different person and with a different sanction.

2. The notice in all cases must be given ten days in advance. See Points 3 and 4 to Section 6—101.

3. The sanction for noncompliance with the section is that the transfer is ineffective against creditors. Comment 2 to Section 6—104 applies.

#### Cross references:

Point 1: Sections 6—107 and 6—108.

Point 2: Points 3 and 4 to Section 6—101.

Point 3: Comment 2 to Section 6—104.

#### Definitional cross references:

"Bulk transfer". Section 6—102.

"Creditor". Sections 1—201 and 6—109.

### NORTH CAROLINA COMMENT

In addition to the requirements of the preceding section, any bulk transfer subject to this article except one made by auction sale (GS 25-6-108) is ineffective against any creditor of the transferor unless at least ten days before he takes possession of the goods or pays for them, whichever happens first, the transferee gives notice of the transfer in the manner and to the persons hereafter provided (GS 25-6-107).

The prior law required that the seller notify the creditors seven days before the proposed sale instead of the ten days required by the UCC.

The sanction seems to be the same. The UCC says the sale is "ineffective against any creditor of the transferor" and the prior law said the sale was void as to creditors. *Raleigh Tire & Rubber Co. v. Morris*, 181 N.C. 184, 106 S.E. 562 (1921). The consequence of noncompliance under both the UCC and the prior North Carolina statute is that a creditor may disregard the transfer and levy on the goods as though they still belonged to the transferor.

**§ 25-6-106. Application of the proceeds.**—In addition to the requirements of the two preceding sections [§§ 25-6-104 and 25-6-105]:

(1) Upon every bulk transfer subject to this article for which new consideration becomes payable except those made by sale at auction it is the duty of the transferee to assure that such consideration is applied so far as necessary to pay those debts of the transferor which are either shown on the list furnished by the transferor (§ 25-6-104) or filed in writing in the place stated in the notice (§ 25-6-107) within thirty days after the mailing of such notice. This duty of the transferee runs to all the holders of such debts, and may be enforced by any of them for the benefit of all.

(2) If any of said debts are in dispute the necessary sum may be withheld from distribution until the dispute is settled or adjudicated.

(3) If the consideration payable is not enough to pay all of the said debts in full distribution shall be made pro rata.

(4) The transferee may within ten days after he takes possession of the goods pay the consideration into the office of the clerk of the superior court in the county where the transferor had its principal place of business in this State and thereafter may discharge his duty under this section by giving notice by registered or certified mail to all the persons to whom the duty runs that the consideration has been paid into that court and that they should file their claims there. On motion of any interested party, the court may order the distribution of the consideration to the persons entitled to it. (1907, c. 623; 1913, c. 30, s. 1; Ex. Sess. 1913, c. 66, s. 1; C. S., s. 1013; 1933, c. 190; 1945, c. 635; 1963, c. 1179; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

#### Purposes:

1. This section applies only to transfers "for which new consideration becomes payable". It applies only if something, which of course need not be money, becomes payable in consideration of the transfer. The purpose of the section is to give the transferor's creditors direct protection against improper dissipation by the transferor of the consideration which he receives

for the transfer. See Comment 4 to Section 6—101.

2. Subsections (6) and (7) of Section 6—103 remove many outright transfers from the operation of this Article and therefore of course of this section. In addition it is clear from the section itself that in any case in which the seller's debts are to be paid as they mature the buyer can disregard the section without danger of added liability except that his seller will

disappoint him. And in case of trouble the buyer is entitled under Section 6—109(2) to credit for sums honestly paid to particular creditors.

3. The methods by which the buyer may perform the duty stated in the section are various. He may, for instance, by agreement with the seller hold the consideration in his own hands until the debts are ascertained, or deposit it in an account subject to checks bearing his counter-signature, or deposit it in escrow with an independent agency. If the affairs of the seller are so involved that nothing else is practical the buyer will no doubt pay the consideration into the registry of an appropriate court and interplead the seller's creditors. If optional subsection (4) is en-

acted, specific provision is made for such a procedure. But notice that the transferee's obligation runs, not to all possible creditors of the transferor who may appear at any time in the future, but only to existing creditors whom the transferee has a chance to identify in one of the ways provided in subsection (1).

**Cross references:**

Point 1: Section 6—108, Comment 4 to Section 6—101.

Point 2: Sections 6—103(6) and (7), 6—109(2).

Point 3: Section 6—109.

**Definitional cross references:**

"Bulk transfer". Section 6—102.

"Creditor". Section 6—109.

"Writing". Section 1—201.

### NORTH CAROLINA COMMENT

This section is new. However, the prior law was somewhat similar in principle since it provided that a person might see that a bond was provided and take the goods free of the claim of creditors: "If the owner of said stock of goods shall at any time before the sale execute a good and sufficient bond, to a trustee therein named, in an amount equal to the actual cash value of the stock of goods, and conditioned that the

seller will apply the proceeds of the sale, subject to the right of the owner or owners to retain therefrom the personal property exemption or exemptions as are allowed by law, as far as they will go in payment of debts actually owing by the owner . . . , then the provisions of this section shall not apply." GS 39-23. The actual payment of the creditors also had the same effect. Otherwise the section is new.

**§ 25-6-107. The notice.**—(1) The notice to creditors (§ 25-6-105) shall state:

(a) that a bulk transfer is about to be made; and

(b) the names and business addresses of the transferor and transferee, and all other business names and addresses used by the transferor within three years last past so far as known to the transferee; and

(c) whether or not all the debts of the transferor are to be paid in full as they fall due as a result of the transaction, and if so, the address to which creditors should send their bills.

(2) If the debts of the transferor are not to be paid in full as they fall due or if the transferee is in doubt on that point then the notice shall state further:

(a) the location and general description of the property to be transferred and the estimated total of the transferor's debts;

(b) the address where the schedule of property and list of creditors (§ 25-6-104) may be inspected;

(c) whether the transfer is to pay existing debts and if so the amount of such debts and to whom owing;

(d) whether the transfer is for new consideration and if so the amount of such consideration and the time and place of payment; and

(e) if for new consideration the time and place where creditors of the transferor are to file their claims.

(3) The notice in any case shall be delivered personally or sent by registered or certified mail to all the persons shown on the list of creditors furnished by the transferor (§ 25-6-104) and to all other persons who are known to the transferee to hold or assert claims against the transferor. (1907, c. 623; 1913, c. 30, s. 1; Ex. Sess. 1913, c. 66, s. 1; C. S., s. 1013; 1933, c. 190; 1945, c. 635; 1963, c. 1179; 1965, c. 700, s. 1.)



**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.  
**Purposes:**

1. This section specifies the contents of the notice to be given on all the transfers covered by Section 6—105 (that is, all transfers subject to the Article except those made by auction sale) and the manner in which it is to be given.

2. Under the section, if the debts of the transferor are to be paid in full as they fall due, a short form of notice is provided. This facilitates honest and solvent transactions.

3. If the transfer is by auction sale Section 6—108 applies.

4. Subsection (2) (e) is a corollary of Section 6—106 and should be omitted if that section is. See note to Section 6—106.

**Cross references:**

Point 1: Section 6—105.

Point 3: Section 6—108.

Point 4: Note to Section 6—106.

**Definitional cross references:**

"Bulk transfer". Section 6—102.

"Creditor". Sections 1—201 and 6—109.

"Person". Section 1—201.

**NORTH CAROLINA COMMENT**

The UCC provides that where the debts are to be paid, a short form may be used. When debts are not to be paid in full, a longer form is to be used. It is suggested that it may be dangerous for the buyer ever to rely on the short form, for all the debts might not be paid in full. At any rate the prior law required the same notice in any case: "shall notify the creditors of the proposed sale, and the price, terms and conditions thereof." GS 39-23. The details were not set out in the prior law, but whether

the statute had been complied with on this point was for the determination of the jury. *Gallup & Co. v. Rozier*, 172 N.C. 283, 90 S.E. 209 (1916).

The prior law also required that "an inventory showing the quantity and, so far as possible, the cost price to the seller of such articles included in the sale . . ." be made. GS 39-23.

The other details of this section are new. The method of giving notice is also new.

§ 25-6-108. **Auction sales; "auctioneer."**—(1) A bulk transfer is subject to this article even though it is by sale at auction, but only in the manner and with the results stated in this section.

(2) The transferor shall furnish a list of his creditors and assist in the preparation of a schedule of the property to be sold, both prepared as before stated (§ 25-6-104).

(3) The person or persons other than the transferor who direct, control or are responsible for the auction are collectively called the "auctioneer." The auctioneer shall:

(a) receive and retain the list of creditors and prepare and retain the schedule of property for the period stated in this article (§ 25-6-104);

(b) give notice of the auction personally or by registered or certified mail at least ten days before it occurs to all persons shown on the list of creditors and to all other persons who are known to him to hold or assert claims against the transferor; and

(c) assure that the net proceeds of the auction are applied as provided in this article (§ 25-6-106).

(4) Failure of the auctioneer to perform any of these duties does not affect the validity of the sale or the title of the purchasers, but if the auctioneer knows that the auction constitutes a bulk transfer such failure renders the auctioneer liable to the creditors of the transferor as a class for the sums owing to them from the transferor up to but not exceeding the net proceeds of the auction. If the auctioneer consists of several persons their liability is joint and several. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.  
**Purposes:**

1. The section is intended to make appropriate application of the requirements of this Article to auction sales. It is clear that the provisions of the four previous

sections in their literal form cannot be applied directly to an auction, since neither the price nor the identity of the purchaser or purchasers can be known until the sale occurs. But it is equally clear that if auctions were excluded entirely from the

transfers covered by this Article the way would be open to a debtor to carry out a bulk transfer of his property without notice to his creditors and without any duty upon anyone to see to the application of the proceeds. The section attempts to meet this situation by imposing the obligations stated in the section upon the persons there described.

2. Since the obligation to give advance notice, etc., cannot rest upon bidders at an auction it is clear that the sale must be effective so far as they are concerned whether or not the section is complied with. Subsection (4) therefore states a sanction which does not affect the purchasers. Notice that the sanction applies only "if the

auctioneer knows that the auction constitutes a bulk transfer." No doubt in some cases, as for instance when goods are simply received on consignment for sale, he may not know.

3. Subsection (3) (c) is a corollary of Section 6—106 and should be omitted if that section is. See note to that section.

#### Cross references:

Point 1: Sections 6—104 through 6—107.

Point 2: Sections 6—104 through 6—107.

Point 3: Section 6—106 and note thereto.

#### Definitional cross references:

"Bulk transfer". Section 6—102.

"Creditor". Sections 1—201 and 6—109.

"Person". Section 1—201.

"Purchaser". Section 1—201.

### NORTH CAROLINA COMMENT

There is no case in North Carolina determining whether an auction sale had to comply with the Bulk Sales Law. There is a conflict in the cases from other jurisdictions that have considered this point. 65 Harv. L. Rev. 422 (1952).

It is probably proper to consider the section as a new section.

The Massachusetts Annotations to this section have the following interesting comment about subsection (3): "The definition of 'auctioneer' is broad enough to include the transferor's lawyer if he directs, controls or is responsible for the auction."

**§ 25-6-109. What creditors protected; credit for payment to particular creditors.**—(1) The creditors of the transferor mentioned in this article are those holding claims based on transactions or events occurring before the bulk transfer, but creditors who become such after notice to creditors is given (§§ 25-6-105 and 25-6-107) are not entitled to notice.

(2) Against the aggregate obligation imposed by the provisions of this article concerning the application of the proceeds (§ 25-6-106 and subsection (3) (c) of 25-6-108) the transferee or auctioneer is entitled to credit for sums paid to particular creditors of the transferor, not exceeding the sums believed in good faith at the time of the payment to be properly payable to such creditors. (1907, c. 623; 1913, c. 30, s. 1; Ex. Sess. 1913, c. 66, s. 1; C. S., s. 1013; 1933, c. 190; 1945, c. 635; 1963, c. 1179; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

#### Purposes:

1. Subsection (1) identifies the creditors who may have rights under the various provisions of this Article. The claims referred to of course include unliquidated claims.

2. Subsection (2) gives the transferee or auctioneer appropriate credit for honest payments to particular creditors. If Section 6—106 is omitted this subsection should be also. See note to that section.

#### Cross references:

Point 1: Sections 6—104 through 6—108.

Point 2: Section 6—106 and note thereto.

#### Definitional cross references:

"Auctioneer". Section 6—108.

"Bulk transfer". Section 6—102.

"Creditor". Section 1—201.

"Good faith". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* North Carolina was in accord with this subsection. The prior Bulk Sales Law required notice to creditors at the time of the sale. *Farmers' Bank & Trust Co. v. Murphy*, 189 N.C. 479, 127 S.E. 527 (1925).

*Subsection (2):* Subsection (2) is new except for the effect of actual application of the proceeds of a sale to debts actually owed. "If the owner of said stock of goods shall . . . execute a . . . bond . . . conditioned that the seller will apply the pro-

ceeds of the sale . . . as far as they will go in payment of debts . . . or if in fact the proceeds are so applied, then the provisions of this section shall not apply." GS 39-23.

**§ 25-6-110. Subsequent transfers.**—When the title of a transferee to property is subject to a defect by reason of his noncompliance with the requirements of this article, then:

(1) a purchaser of any of such property from such transferee who pays no value or who takes with notice of such noncompliance takes subject to such defect, but

(2) a purchaser for value in good faith and without such notice takes free of such defect. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. The section deals with subsequent transfers by the transferee.

2. The second transfer may of course itself be a "bulk transfer" subject to this Article. Whether it is or not will depend on its own character under Sections 6—102 and 6—103.

**Cross references:**

Point 2: Sections 6—102 and 6—103.

**Definitional cross references.**

"Good faith". Section 1—201.

"Notice". Section 1—201.

"Purchaser". Section 1—201.

"Value". Section 1—201.

#### NORTH CAROLINA COMMENT

*Subsection (1):* The prior law seems to have been in accord with this subsection. The court in *Raleigh Tire & Rubber Co. v. Morris*, 181 N.C. 184, 106 S.E. 562 (1921), said, "And when avoided as to creditors of the vendor by reason of failure to comply with the statutory requirements the goods can be made available by direct process of levy and sale in the hands of the original purchaser, and being out of the usual course of business, and so affecting him with notice, such purchaser may be held liable for their value

when they have been disposed of by him under the principles recognized and applied in the well-considered case of *Sprinkle v. Wellborn*, 140 N.C. 163, 52 S.E. 666 (1905), and either remedy may be pursued by the creditors of the vendor as against subsequent purchasers as long as the goods can be identified or until they pass into the hands of a bona fide purchaser for value and without notice."

*Subsection (2):* The same principle as subsection (1).

**§ 25-6-111. Limitation of actions and levies.**—No action under this article shall be brought nor levy made more than six months after the date on which the transferee took possession of the goods unless the transfer has been concealed. If the transfer has been concealed, actions may be brought or levies made within six months after its discovery. (1907, c. 623; 1913, c. 30, s. 1; Ex. Sess. 1913, c. 66, s. 1; C. S., s. 1013; 1933, c. 190; 1945, c. 635; 1963, c. 1179; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. This Article imposes unusual obligations on buyers of property. A short statute of limitations is therefore appropriate.

2. The main sanction for non-compliance with the Article is that the transfer "is ineffective against any creditor of the transferor." Sections 6—104, 6—105. This means, e.g., that a judgment creditor of the transferor may levy execution on the property. See Comment 2 to Section 6—104.

In such a case, which may be expected to be frequent, no "action under this Article" will be necessary. The action will have been brought and prosecuted to judgment on

whatever the claim was. The only thing done "under this Article" will be the levy and resulting sale.

The short statute of limitations is therefore made applicable to levies as well as actions. "Levy", which is not a defined term in the Code, should be read broadly as including not only levies of execution proper but also attachment, garnishment, trustee process, receivership, or whatever proceeding, under the state's practice, is used to apply a debtor's property to payment of his debts.

**Definitional cross reference:**

"Action". Section 1—201.



## NORTH CAROLINA COMMENT

The UCC has a six months' statute of limitations instead of the prior twelve months' statute of limitations. The prior statute was not clear on this point. The prior statute required that the creditor make demand upon the purchaser in good faith or the trustee named in the bond, if a bond was executed, "within twelve months from the date of maturity of his claim." Literally, this might be taken to mean that if a claim matured more than twelve months before the sale, the statute of limitations would prevent an action. However, the stat-

ute also said, ". . . and any creditor who does not present his claim or make demand either upon the purchaser in good faith or on the trustee named in a bond within twelve months from the date of its maturity shall be barred . . ." Here, it seems that where there was a bond, there was a twelve months' statute of limitations. Probably the statute of limitations for our prior Bulk Sales Law was twelve months. If so, the UCC clarifies the law and provides a shorter statute of limitations.

## ARTICLE 7.

*Warehouse Receipts, Bills of Lading and Other Documents of Title.*

## PART 1.

## GENERAL.

§ 25-7-101. **Short title.**—This article shall be known and may be cited as Uniform Commercial Code—Documents of Title. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

This Article is a consolidation and revision of the Uniform Warehouse Receipts Act and the Uniform Bills of Lading Act, and embraces also the provisions of the Uniform Sales Act relating to negotiation of documents of title.

The only substantial omissions of material covered in the previous uniform acts are the criminal provisions found in the Warehouse Receipts and Bills of Lading Acts. These criminal provisions are inappropriate to a Commercial Code, and for the most part duplicate portions of the ordinary criminal law relating to frauds.

The Article does not attempt to define the tort liability of bailees, except to hold certain classes of bailees to a minimum standard of reasonable care. For important classes of bailees, liabilities in case of loss, damage or destruction, as well as other legal questions associated with particular documents of title, are governed by federal statutes, international treaties, and in some cases regulatory state laws, which supersede the provisions of this Article in case of inconsistency. See Section 7—103.

§ 25-7-102. **Definitions and index of definitions.**—(1) In this article, unless the context otherwise requires:

(a) "Bailee" means the person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them.

(b) "Consignee" means the person named in a bill to whom or to whose order the bill promises delivery.

(c) "Consignor" means the person named in a bill as the person from whom the goods have been received for shipment.

(d) "Delivery order" means a written order to deliver goods directed to a warehouseman, carrier or other person who in the ordinary course of business issues warehouse receipts or bills of lading.

(e) "Document" means document of title as defined in the general definitions in article 1 (§ 25-1-201).

(f) "Goods" means all things which are treated as movable for the purposes of a contract of storage or transportation.

(g) "Issuer" means a bailee who issues a document except that in relation to an unaccepted delivery order it means the person who orders the possessor of goods to deliver. Issuer includes any person for whom an agent or employee pur-

ports to act in issuing a document if the agent or employee has real or apparent authority to issue documents, notwithstanding that the issuer received no goods or that the goods were misdescribed or that in any other respect the agent or employee violated his instructions.

(h) "Warehouseman" is a person engaged in the business of storing goods for hire.

(2) Other definitions applying to this article or to specified parts thereof, and the sections in which they appear are:

"Duly negotiate." § 25-7-501.

"Person entitled under the documents." § 25-7-403 (4).

(3) Definitions in other articles applying to this article and the sections in which they appear are:

"Contract for sale." § 25-2-106.

"Overseas." § 25-2-323.

"Receipt" of goods. § 25-2-103.

(4) In addition article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. (1917, c. 37, s. 58; 1919, c. 65, s. 42; C. S., ss. 280, 4037; 1965, c. 700, s. 1.)

**Cross Reference.** — As to public warehouses in general, see §§ 66-35 to 66-40.

**What Constitutes Warehouseman.** — It mattered not if a concern was a person or partnership. If the concern was engaged in the business and goods were stored for

profit, the Uniform Warehouse Receipts Act applied. It mattered not if the concern stored its own and also the goods of others. *Webb & Co. v. Friedberg*, 189 N.C. 166, 126 S.E. 508 (1925).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Sections 1 and 53, Uniform Bills of Lading Act.

**Changes:** Applicable definitions from the uniform acts have been consolidated and revised; definition of delivery order is new.

**Purposes of changes and new matter:**

1. "Bailee" was not defined in the old uniform acts. It is used in this Article as a blanket term to designate carriers, warehousemen and others who normally issue documents of title on the basis of goods which they have received. The definition does not, however, require actual possession of the goods. If a bailee acknowledges possession when he does not have it he is bound by sections of this Article which declare the "bailee's" obligations. (See definition of "Issuer" in this section and Sections 7—203 and 7—301 on liability in case of non-receipt.)

2. The definition of warehouse receipt contained in the general definitions section of this Act (Section 1—201) eliminates the requirement of the Uniform Warehouse Receipts Act that the issuing warehouseman be "lawfully engaged" in business. The warehouseman's compliance with applicable state regulations such as the filing of a bond has no bearing on the substantive issues dealt with in this Article. Certainly the issuer's violations of law should not diminish his responsibility on

documents he has put in commercial circulation. The Uniform Warehouse Receipts Act requirement that the warehouseman be engaged "for profit" has also been eliminated in view of the existence of state operated and co-operative warehouses. But it is still essential that the business be storing goods "for hire" (Section 1—201 and this section). A person does not become a warehouseman by storing his own goods.

3. Delivery orders, which were included without qualification in the Uniform Sales Act definition of document of title, must be treated differently in this consolidation of provisions from the three uniform acts. When a delivery order has been accepted by the bailee it is for practical purposes indistinguishable from a warehouse receipt. Prior to such acceptance there is no basis for imposing obligations on the bailee other than the ordinary obligation of contract which the bailee may have assumed to the depositor of the goods.

**Cross references:**

Point 1: Sections 7—203 and 7—301.

Point 2: Sections 1—201 and 7—203.

See general comment to document of title in Section 1—201.

**Definitional cross references:**

"Contract". Section 1—201.

"Bill of lading". Section 1—201.

"Contract for sale". Section 2—106.

"Delivery". Section 1—201.

"Document of title". Section 1—201.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Receipt of goods". Section 2—103.

"Right". Section 1—201.

"Warehouse receipt". Section 1—201.

"Written". Section 1—201.

#### NORTH CAROLINA COMMENT

##### *Subsection (1):*

(a) This paragraph is new. The prior uniform acts did not define "bailee."

(b) "Consignee": Present law similar in meaning, but UCC adds "or to whose order" to definition in GS 21-1.

(c) "Consignor": Definition in UCC almost identical to definition in GS 21-1.

(d) "Delivery order": This paragraph is new.

(e) "Document": This paragraph is new.

(f) "Goods": Wording different, but meaning apparently very similar. See GS 21-1 and 27-2.

(g) "Issuer": New.

(h) "Warehouseman": As noted in the Official Comment, this is a new definition. Now it is not necessary that one be "lawfully engaged," nor is it necessary for one to be engaged for "profit."

§ 25-7-103. **Relation of article to treaty, statute, tariff, classification or regulation.**—To the extent that any treaty or statute of the United States, regulatory statute of this State or tariff, classification or regulation filed or issued pursuant thereto is applicable, the provisions of this article are subject thereto. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

##### **Purposes:**

1. To make clear what would of course be true without the section, that applicable Federal law is paramount.

2. To make clear also that *regulatory* State statutes (such as those fixing or authorizing a commission to fix rates and prescribe services, authorizing different charges for goods of different values, and limiting liability for loss to the declared value on which the charge was based) are

not affected by the Article and are controlling on the matters which they cover. Notice that the reference is not only to such statutes, but to tariffs, classifications and regulations filed or issued pursuant to them.

##### **Cross references:**

Sections 7—201, 7—202, 7—204, 7—206, 7—309, 7—401, 7—403.

##### **Definitional cross reference:**

"Bill of lading". Section 1—201.

#### NORTH CAROLINA COMMENT

This section is new, but same as prior law.

§ 25-7-104. **Negotiable and nonnegotiable warehouse receipt, bill of lading or other document of title.**—(1) A warehouse receipt, bill of lading or other document of title is negotiable

(a) if by its terms the goods are to be delivered to bearer or to the order of a named person; or

(b) where recognized in overseas trade, if it runs to a named person or assigns.

(2) Any other document is nonnegotiable. A bill of lading in which it is stated that the goods are consigned to a named person is not made negotiable by a provision that the goods are to be delivered only against a written order signed by the same or another named person. (Rev., s. 3032; 1917, c. 37, ss. 4, 7; 1919, c. 65, ss. 3, 6, 7; C. S., ss. 285, 288, 289, 4044, 4045; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 27 and 76, Uniform Sales Act; Sections 2, 3, 4, 5 and 59, Uniform Warehouse Receipts Act; Sections 2, 3, 4, 5 and 53, Uniform Bills of Lading Act.

**Changes:** Consolidated and rewritten.

##### **Purposes of changes:**

This Article deals with a class of commercial paper representing commodities in

storage or transportation. This "commodity paper" is to be distinguished from what might be called "money paper" dealt with in the Article of this Act on Commercial Paper (Article 3) and "investment paper" dealt with in the Article of this Act on Investment Securities (Article 8). The class of "commodity paper" is designated "document of title" following the terminol-



ogy of the Uniform Sales Act Section 76. Section 1—201. The distinctions between negotiable and nonnegotiable documents in this section make the most important subclassification employed in the Article, in that the holder of negotiable documents may acquire more rights than his transferor had (see Section 7—502).

A document of title is negotiable only if it satisfies this section. "Deliverable on proper indorsement and surrender of this receipt" will not render a document negotiable. Bailees often include such provisions as a means of insuring return of nonnegotiable receipts for record purposes. Such language may be regarded as insistence by the bailee upon a particular

kind of receipt in connection with delivery of the goods. Subsections (1) (a) and (2) make it clear that a document is not negotiable which provides for delivery to order or bearer only if written instructions to that effect are given by a named person.

**Cross reference:**

Section 7—502.

**Definitional cross references:**

"Bearer". Section 1—201.

"Bill of lading". Section 1—201.

"Delivery". Section 1—201.

"Document of title". Section 1—201.

"Overseas". Section 2—323.

"Person". Section 1—201.

"Warehouse receipt". Section 1—201.

### NORTH CAROLINA COMMENT

Prior law did not provide for "bearer" type bill of lading. See GS 21-3 and 21-8. Prior law required that a nonnegotiable, that is, a straight bill of lading, should be plainly marked "nonnegotiable." GS 21-7. UCC does not. Prior law required that warehouse receipts be plainly marked "not negotiable." GS 27-9. UCC does not. Prior law provided that "no provisions shall be inserted in a negotiable receipt that it is nonnegotiable," and prior law also pro-

vided that a provision stating an order bill of lading is nonnegotiable was void. GS 21-3. The UCC has omitted this language. The meaning is probably the same.

Paragraph (b) is new.

Subsection (2): The UCC defines negotiable documents and provides that all documents that do not meet the definition are nonnegotiable. Therefore, the UCC omits the definition of nonnegotiable, such as GS 21-7 and 27-8.

**§ 25-7-105. Construction against negative implication.**—The omission from either part 2 or part 3 of this article of a provision corresponding to a provision made in the other part does not imply that a corresponding rule of law is not applicable. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

To avoid any impairment, for example, of any common-law right of indemnity a warehouseman may have corresponding to

Section 7—301(5), or of any contractual security interest a carrier might have corresponding to Section 7—209(2).

**Cross references:**

Parts 2 and 3 of Article 7.

## PART 2.

### WAREHOUSE RECEIPTS: SPECIAL PROVISIONS.

**§ 25-7-201. Who may issue a warehouse receipt; storage under government bond.**—(1) A warehouse receipt may be issued by any warehouseman.

(2) Where goods including distilled spirits and agricultural commodities are stored under a statute requiring a bond against withdrawal or a license for the issuance of receipts in the nature of warehouse receipts, a receipt issued for the goods has like effect as a warehouse receipt even though issued by a person who is the owner of the goods and is not a warehouseman. (1917, c. 37, s. 1; C. S., s. 4041; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 1, Uniform Warehouse Receipts Act.

**Changes:** Provision added to cover storage under government bond or under licensing statute.

**Purposes.**

It is not intended by reenactment of subsection (1) to repeal any provisions of special licensing or other statutes regulating who may become a warehouseman. See

Section 10—103. Subsection (2) covers receipts issued by the owner for whiskey or other goods stored in bonded warehouses under such statutes as 26 U.S.C. Chapter 26. Limitations on the transfer of the receipts and criminal sanctions for violation of such limitations are not impaired. Sec-

tion 7—103. Compare Section 7—401(d) on the liability of the issuer in such cases.

**Cross references:**

Sections 7—103, 7—401, 10—103.

**Definitional cross references:**

"Warehouse receipt". Section 1—201.

"Warehouseman". Section 7—102.

**NORTH CAROLINA COMMENT**

*Subsection (1):* Same as GS 27-5.

*Subsection (2):* This is new.

**§ 25-7-202. Form of warehouse receipt; essential terms; optional terms.**—(1) A warehouse receipt need not be in any particular form.

(2) Unless a warehouse receipt embodies within its written or printed terms each of the following, the warehouseman is liable for damages caused by the omission to a person injured thereby:

- (a) the location of the warehouse where the goods are stored;
- (b) the date of issue of the receipt;
- (c) the consecutive number of the receipt;
- (d) a statement whether the goods received will be delivered to the bearer, to a specified person, or to a specified person or his order;
- (e) the rate of storage and handling charges, except that where goods are stored under a field warehousing arrangement a statement of that fact is sufficient on a nonnegotiable receipt;
- (f) a description of the goods or of the packages containing them;
- (g) the signature of the warehouseman, which may be made by his authorized agent;
- (h) if the receipt is issued for goods of which the warehouseman is owner, either solely or jointly or in common with others, the fact of such ownership; and
- (i) a statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien or security interest (§ 25-7-209). If the precise amount of such advances made or of such liabilities incurred is, at the time of the issue of the receipt, unknown to the warehouseman or to his agent who issues it, a statement of the fact that advances have been made or liabilities incurred and the purpose thereof is sufficient.

(3) A warehouseman may insert in his receipt any other terms which are not contrary to the provisions of this chapter and do not impair his obligation of delivery (§ 25-7-403) or his duty of care (§ 25-7-204). Any contrary provisions shall be ineffective. (Rev., s. 3032; 1917, c. 37, ss. 2, 3; C. S., ss. 4042, 4043; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 2, Uniform Warehouse Receipts Act.

**Changes:** Exemption for field warehouse receipts added in subsection (2) (e).

**Purposes:**

To make clear that the formal requirements of the Uniform Warehouse Receipts Act are continued but not to displace particular legislation requiring other or different specifications of form, see Sections 7—103 and 10—103. This section does not require that a receipt be issued but states formal requirements for those which are issued.

**Cross references:**

Sections 7—103 and 10—103.

**Definitional cross references:**

"Bearer". Section 1—201

"Delivery". Section 1—201.

"Goods". Section 7—102.

"Person". Section 1—201.

"Security interest". Section 1—201.

"Term". Section 1—201.

"Warehouse receipt". Section 1—201.

"Warehouseman". Section 7—102.

"Written". Section 1—201.

**NORTH CAROLINA COMMENT**

*Subsection (1):* This is similar to GS 27-6. Prior law made warehouseman liable for injury caused by omission of required information when it was omitted from a

negotiable receipt. The UCC creates liability for all injury, both in negotiable and nonnegotiable receipts. See GS 27-6.

*Subsection (2):* This seems identical to prior law except for the provision in UCC which excepts from requirement of rate of

storage goods that are stored under a field warehousing arrangement. Prior law did not contain the exception. See GS 27-6 (6).

*Subsection (3):* This is similar to GS 27-7.

**§ 25-7-203. Liability for non-receipt or misdescription.**—A party to or purchaser for value in good faith of a document of title other than a bill of lading relying in either case upon the description therein of the goods may recover from the issuer damages caused by the non-receipt or misdescription of the goods, except to the extent that the document conspicuously indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, as where the description is in terms of marks or labels or kind, quantity or condition, or the receipt or description is qualified by “contents, condition and quality unknown,” “said to contain” or the like, if such indication be true, or the party or purchaser otherwise has notice. (1917, c. 37, s. 20; C. S., s. 4060; 1931, c. 358, s. 1; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 20, Uniform Warehouse Receipts Act.

**Changes:** New section confined to problem of non-receipt and misdescription.

**Purposes of changes and new matter:**

This section is a simplified restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor. The issuer is liable on documents issued by an agent, contrary to instructions of his principal, without receiving goods. No disclaimer of the latter liability is permitted.

**Cross references:**

Sections 7—301 and 7—203.

**Definitional cross references:**

“Conspicuous”. Section 1—201.

“Document”. Section 7—102.

“Document of title”. Section 1—201.

“Goods”. Section 7—102.

“Issuer”. Section 7—102.

“Notice”. Section 1—201.

“Party”. Section 1—201.

“Purchaser”. Section 1—201.

“Receipt of goods”. Section 2—103.

“Value”. Section 1—201.

#### NORTH CAROLINA COMMENT

The prior law provided a remedy for “nonexistence” rather than “nonreceipt.” GS 27-24. The meaning is the same, even though the language about issuance by an

“agent” has been omitted, for GS 25-7-102 (g) gives same meaning as omitted part of GS 27-24.

**§ 25-7-204. Duty of care; contractual limitation of warehouseman's liability.**—(1) A warehouseman is liable for damages for loss of or injury to the goods caused by his failure to exercise such care in regard to them as a reasonably careful man would exercise under like circumstances but unless otherwise agreed he is not liable for damages which could not have been avoided by the exercise of such care.

(2) Damages may be limited by a term in the warehouse receipt or storage agreement limiting the amount of liability in case of loss or damage, and setting forth a specific liability per article or item, or value per unit of weight, beyond which the warehouseman shall not be liable; provided, however, that such liability may on written request of the bailor at the time of signing such storage agreement or within a reasonable time after receipt of the warehouse receipt be increased on part or all of the goods thereunder, in which event increased rates may be charged based on such increased valuation, but that no such increase shall be permitted contrary to a lawful limitation of liability contained in the warehouseman's tariff, if any. No such limitation is effective with respect to the warehouseman's liability for conversion to his own use.

(3) Reasonable provisions as to the time and manner of presenting claims and



instituting actions based on the bailment may be included in the warehouse receipt or tariff.

(4) This section does not impair or repeal any statute which imposes a higher responsibility upon the warehouseman or invalidates contractual limitations which would be permissible under this article. (1917, c. 37, s. 21; C. S., s. 4061; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 3 and 21, Uniform Warehouse Receipts Act.

**Changes:** Consolidated and rewritten; material on limitation of remedy is new.

##### Purposes of changes:

The old uniform acts provided that receipts could not contain terms impairing the obligation of reasonable care. Whether this is violated by a stipulation that in case of loss the bailee's liability is limited to stated amounts has been much controverted. The section is intended to eliminate that controversy by setting forth the conditions under which liability is so limited. However, as subsection (4) makes clear, the states as well as the federal govern-

ment may supplement this section with more rigid standards of responsibility for some or all bailees.

##### Cross references:

Sections 7—103 and 10—103.

##### Definitional cross references:

"Action". Section 1—201.

"Agreed". Section 1—201.

"Goods". Section 7—102.

"Reasonable time". Section 1—204.

"Sign". Section 1—201.

"Term". Section 1—201.

"Value". Section 1—201.

"Warehouse receipt". Section 1—201.

"Warehouseman". Section 7—102.

"Written". Section 1—201.

#### NORTH CAROLINA COMMENT

The prior law was similar in meaning, except that there was nothing in the statute concerning the extent to which a warehouseman might enforce provisions limit-

ing damages and there were no cases on this point. See GS 27-25. In other words, subsections (2) and (3) are new.

§ 25-7-205. Title under warehouse receipt defeated in certain cases. —A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

##### Purposes:

The typical case covered by this section is that of the warehouseman-dealer in grain, and the substantive question at issue is whether in case the warehouseman becomes insolvent the receipt holders shall be able to trace and recover grain shipped to farmers and other purchasers from the elevator. This was possible under the old acts, although courts were eager to find estoppels to prevent it. The practical difficulty of tracing fungible grain means that the preservation of this theoretical right adds little to the commercial acceptability of negotiable grain receipts, which really circulate on the credit of the warehouseman. Moreover, on default of the warehouseman, the receipt holders at least

share in what grain remains, whereas retaking the grain from a good faith cash purchaser reduces him completely to the status of general creditor in a situation where there was very little he could do to guard against the loss. Compare 15 U.S.C. Section 714p, enacted in 1955.

##### Cross references:

Sections 2—403 and 9—307.

##### Definitional cross references:

"Buyer in ordinary course of business". Section 1—201.

"Delivery". Section 1—201.

"Duly negotiate". Section 7—501

"Fungible" goods. Section 1—201.

"Goods". Section 7—102.

"Value". Section 1—201.

"Warehouse receipt". Section 1—201.

"Warehouseman". Section 7—102.

#### NORTH CAROLINA COMMENT

There was no similar provision in the prior statute. But see *Lance v. Butler*, 135

N.C. 419, 47 S.E. 488 (1904), which may be in conflict with this section.

**§ 25-7-206. Termination of storage at warehouseman's option.—**

(1) A warehouseman may on notifying the person on whose account the goods are held and any other person known to claim an interest in the goods require payment of any charges and removal of the goods from the warehouse at the termination of the period of storage fixed by the document, or, if no period is fixed, within a stated period not less than thirty days after the notification. If the goods are not removed before the date specified in the notification, the warehouseman may sell them in accordance with the provisions of the section on enforcement of a warehouseman's lien (§ 25-7-210).

(2) If a warehouseman in good faith believes that the goods are about to deteriorate or decline in value to less than the amount of his lien within the time prescribed in subsection (1) for notification, advertisement and sale, the warehouseman may specify in the notification any reasonable shorter time for removal of the goods and in case the goods are not removed, may sell them at public sale held not less than one week after a single advertisement or posting.

(3) If as a result of a quality or condition of the goods of which the warehouseman had no notice at the time of deposit the goods are a hazard to other property or to the warehouse or to persons, the warehouseman may sell the goods at public or private sale without advertisement on reasonable notification to all persons known to claim an interest in the goods. If the warehouseman after a reasonable effort is unable to sell the goods he may dispose of them in any lawful manner and shall incur no liability by reason of such disposition.

(4) The warehouseman must deliver the goods to any person entitled to them under this article upon due demand made at any time prior to sale or other disposition under this section.

(5) The warehouseman may satisfy his lien from the proceeds of any sale or disposition under this section but must hold the balance for delivery on the demand of any person to whom he would have been bound to deliver the goods. (Rev., ss. 3036 to 3040; 1917, c. 37, ss. 33, 34; C. S., ss. 4073, 4074; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 34, Uniform Warehouse Receipts Act.

**Changes:** Rewritten and expanded to define the warehouseman's right to terminate the storage not only where the goods are perishable or hazardous as in Uniform Warehouse Receipts Act, Section 34, but also for any other reason including decline in value of the goods imperiling the warehouseman's security for charges.

**Purposes of changes:**

1. Most warehousing is for an indefinite term, the bailor being entitled to delivery on reasonable demand. It is necessary to define the warehouseman's power to terminate the bailment, since it would be commercially intolerable to allow warehousemen to order removal of the goods on short notice. The thirty day period provided where the document does not carry its own period of termination corresponds to commercial practice of computing rates on a monthly basis. The right to terminate under subsection (1) includes a right to require payment of "any charges", but does not depend on the existence of unpaid charges.

2. In permitting expeditious disposition of perishable and hazardous goods Uniform

Warehouse Receipts Act, Section 34, made no distinction between cases where the warehouseman knowingly undertook to store such goods and cases where the goods were discovered to be of that character subsequent to storage. The former situation presents no such emergency as justifies the summary power of removal and sale. Subsections (2) and (3) distinguish between the two situations.

3. Protection of his lien is the only interest which the warehouseman has to justify summary sale of perishable goods which are not hazardous. This same interest must be recognized when the stored goods, although not perishable, decline in market value to a point which threatens the warehouseman's security.

4. The right to order removal of stored goods is subject to provisions of the public warehousing laws of some states forbidding warehousemen from discriminating among customers. Nor does the section relieve the warehouseman of any obligation under the state laws to secure the approval of a public official before disposing of deteriorating goods. Such regulatory statutes and the regulations under them

remain in force and operative. Sections 7—103, 10—103.

**Cross references:**

Sections 7—103, 7—403, 10—103.

**Definitional cross references:**

"Delivery". Section 1—201.

"Document". Section 7—102.

"Good faith". Section 1—201.

"Goods". Section 7—102.

"Notice". Section 1—201.

"Notification". Section 1—201.

"Person". Section 1—201.

"Reasonable time". Section 1—204.

"Value". Section 1—201.

"Warehouseman". Section 7—102.

### NORTH CAROLINA COMMENT

This is new in part as indicated in the Official Comment.

*Subsection (1):* This subsection is new. However, the act apparently does not require the warehouseman to continue storage, and even under prior law he may have had the right to terminate storage at any time.

*Subsection (2):* This subsection and subsection (3) make a distinction between goods which the warehouseman knows are perishable or hazardous at the time he receives them for storage and goods whose

hazards are concealed at the time of storage. GS 27-38 did not make this distinction. Where he does not know of nature of goods, UCC allows sale without advertisement. Otherwise not. GS 27-38 allowed such sale whether warehouseman knew or not.

*Subsection (3):* See above, under subsection (2).

*Subsection (4):* Similar to prior law. See GS 27-37 (3).

*Subsection (5):* Similar to prior law. See GS 27-37 (3) and 27-38.

**§ 25-7-207. Goods must be kept separate; fungible goods.**—(1) Unless the warehouse receipt otherwise provides, a warehouseman must keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods except that different lots of fungible goods may be commingled.

(2) Fungible goods so commingled are owned in common by the persons entitled thereto and the warehouseman is severally liable to each owner for that owner's share. Where because of overissue a mass of fungible goods is insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom overissued receipts have been duly negotiated. (Rev., s. 3034; 1917, c. 37, ss. 22 to 24; C. S., ss. 4062 to 4064; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 22 and 23, Uniform Warehouse Receipts Act.

**Changes:** Consolidated and revised; holders of overissued receipts permitted to share in mass of fungible goods.

**Purposes of changes:**

No change of substance is made other than the explicit statement that holders to whom overissued receipts have been duly negotiated shall share in a mass of fungible goods. Where individual ownership interests are merged into claims on a

common fund, as is necessarily the case with fungible goods, there is no policy reason for discriminating between successive purchasers of similar claims.

**Definitional cross references:**

"Delivery". Section 1—201.

"Duly negotiate". Section 7—501.

"Fungible" goods. Section 1—201.

"Goods". Section 7—102.

"Holder". Section 1—201.

"Person". Section 1—201.

"Warehouse receipt". Section 1—201.

"Warehouseman". Section 7—102.

### NORTH CAROLINA COMMENT

*Subsection (1):* Similar to prior law, GS 27-26, except that prior law permitted commingling of fungible goods only "if authorized by agreement or by custom."

UCC permits commingling of fungible goods without permission.

*Subsection (2):* This is similar to GS 27-27 and 27-28.

**§ 25-7-208. Altered warehouse receipts.**—Where a blank in a negotiable warehouse receipt has been filled in without authority, a purchaser for value and without notice of the want of authority may treat the insertion as authorized. Any other unauthorized alteration leaves any receipt enforceable against the issuer according to its original tenor. (1917, c. 37, s. 13; C. S., s. 4053; 1965, c. 700, s. 1.)



**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 13, Uniform Warehouse Receipts Act.

**Changes:** Generally revised and simplified; explicit treatment of the situation where a blank in an executed document is filled without authority.

**Purposes of changes:**

1. The execution of warehouse receipts in blank is a dangerous practice. As between the issuer and an innocent purchaser the risks should clearly fall on the former.

2. An unauthorized alteration whether

made with or without fraudulent intent does not relieve the issuer of his liability on the warehouse receipt as originally executed. The unauthorized alteration itself is of course ineffective against the warehouseman.

**Definitional cross references:**

"Issuer". Section 7—102.

"Notice". Section 1—201.

"Purchaser". Section 1—201.

"Value". Section 1—201.

"Warehouse receipt". Section 1—201.

**NORTH CAROLINA COMMENT**

This is similar to prior law, GS 27-27, but expands the liability of the warehouseman to some extent. The UCC holds the

warehouseman to the terms of a negotiable receipt even though a blank had been filled in without authority.

§ 25-7-209. **Lien of warehouseman.**—(1) A warehouseman has a lien against the bailor on the goods covered by a warehouse receipt or on the proceeds thereof in his possession for charges for storage or transportation (including demurrage and terminal charges), insurance, labor, or charges present or future in relation to the goods, and for expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law. If the person on whose account the goods are held is liable for like charges or expenses in relation to other goods whenever deposited and it is stated in the receipt that a lien is claimed for charges and expenses in relation to other goods, the warehouseman also has a lien against him for such charges and expenses whether or not the other goods have been delivered by the warehouseman. But against a person to whom a negotiable warehouse receipt is duly negotiated a warehouseman's lien is limited to charges in an amount or at a rate specified on the receipt or if no charges are so specified then to a reasonable charge for storage of the goods covered by the receipt subsequent to the date of the receipt.

(2) The warehouseman may also reserve a security interest against the bailor for a maximum amount specified on the receipt for charges other than those specified in subsection (1), such as for money advanced and interest. Such a security interest is governed by the article on secured transactions (article 9).

(3) A warehouseman's lien for charges and expenses under subsection (1) or a security interest under subsection (2) is also effective against any person who so entrusted the bailor with possession of the goods that a pledge of them by him to a good faith purchaser for value would have been valid but is not effective against a person as to whom the document confers no right in the goods covered by it under § 25-7-503.

(4) A warehouseman loses his lien on any goods which he voluntarily delivers or which he unjustifiably refuses to deliver. (1917, c. 37, ss. 27 to 31; C. S., ss. 4067 to 4071; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 27 through 32, Uniform Warehouse Receipts Act.

**Changes:** Rewritten.

**Purposes of changes:**

1. Subsection (1) defines the warehouseman's statutory lien. A specific lien attaches automatically, without express notation on the receipt, to goods stored under a non-

negotiable receipt. That lien is limited to the usual charges arising out of a storage transaction; by notation on the receipt it can be made a general lien extending to like charges in relation to other goods. The same rules apply where the receipt is negotiable, except that as against a holder by due negotiation the lien is limited to the amount or rate specified on the receipt,

or, if none is specified, to a reasonable charge for storage of the specific goods after the date of the receipt.

2. Subsection (2) provides for a security interest based upon agreement. Such a security interest arises out of relations between the parties other than bailment for storage or transportation, as where the bailee assumes the role of financier or performs a manufacturing operation, extending credit in reliance upon the goods covered by the receipt. Such a security interest is not a statutory lien. Compare Sections 9—102(2) and 9—310. It is governed in all respects by Article 9, except that subsection (2) requires that the receipt specify a maximum amount and limits the security interest to the amount specified.

3. Subsections (1) and (2) validate the lien and security interest "against the bailor." As against third parties, subsection (3) continues the rule under the prior uniform statutory provision that to validate the lien the owner must have entrusted the goods to the depositor, and that the circumstances must be such that a pledge by the depositor to a good faith purchaser for value would have been valid. Thus the owner's interest will not be subjected to a lien or security interest arising out of a deposit of his goods by a thief. The warehouseman may be protected because of the actual, implied or apparent authority of the depositor, because of a Factor's Act, or because of other circumstances which would protect a bona fide pledgee, unless those circumstances are denied effect under Section 7—503. Where the third party is the holder of a security interest, the rights of the warehouseman depend on the priority given to a hypothetical bona fide pledgee by Article 9, particularly Section 9—312. Thus the special priority granted to statutory liens by Section 9—310 does not apply to liens under subsection (1) of this section, since subsection (3) "expressly provides otherwise" within the meaning of Section 9—310.

4. It is unnecessary to state here, as in Uniform Warehouse Receipts Act 31, that a bailee with a valid lien need not deliver until the lien is satisfied. Section 7—403

provides that a person demanding delivery under a document must be prepared to satisfy the bailee's lien.

5. Where goods have been stored under a non-negotiable warehouse receipt and are sold by the person to whom the receipt has been issued, frequently the goods are not withdrawn by the new owner. The obligations of the seller of the goods in this situation are set forth in Section 2—503(4) on tender of delivery and include procurement of an acknowledgement by the bailee of the buyer's right to possession of the goods. If a new receipt is requested, such an acknowledgment can be withheld until storage charges have been paid or provided for. The statutory lien for charges on the goods sold, granted by the first sentence of subsection (1), continues valid unless the bailee gives it up. But once a new receipt is issued to the buyer, the buyer becomes "the person on whose account the goods are held" under the second sentence of subsection (1); unless he undertakes liability for charges in relation to other goods stored by the seller, there is no general lien against the buyer for such charges. Of course, the bailee may preserve the general lien in such a case either by an arrangement by which the buyer "is liable for" such charges, or by reserving a security interest under subsection (2).

#### Cross references:

Point 2: Sections 9—102(2) and 9—310.

Point 3: Sections 7—503, 9—310 and 9—312.

Point 4: Section 7—403.

Point 5: Section 2—503.

#### Definitional cross references:

"Deliver". Section 1—201.

"Document". Section 7—102.

"Goods". Section 7—102.

"Money". Section 1—201.

"Person". Section 1—201.

"Purchaser". Section 1—201.

"Right". Section 1—201.

"Security interest". Section 1—201.

"Value". Section 1—201.

"Warehouse receipt". Section 1—201.

"Warehouseman". Section 7—102.

### NORTH CAROLINA COMMENT

*Subsection (1):* This is substantially the same as GS 27-31, 27-32 and 27-34. Notice, however, that the last sentence requires that the receipt be "duly negotiated" if the special rule is to apply.

*Subsection (2):* This subsection probably covers what was covered by GS 27-31

and 27-35. Notice Official Comment 2, which indicates that enforcement of the security interest is governed by article 9.

*Subsection (3):* This is similar to GS 27-32.

*Subsection (4):* This is similar to GS 27-33.

**§ 25-7-210. Enforcement of warehouseman's lien.**—(1) Except as provided in subsection (2), a warehouseman's lien may be enforced by public or pri-

vate sale of the goods in block or in parcels, at any time or place and on any terms which are commercially reasonable, after notifying all persons known to claim an interest in the goods. Such notification must include a statement of the amount due, the nature of the proposed sale and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the warehouseman is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the warehouseman either sells the goods in the usual manner in any recognized market therefor, or if he sells at the price current in such market at the time of his sale, or if he has otherwise sold in conformity with commercially reasonable practices among dealers in the type of goods sold, he has sold in a commercially reasonable manner. A sale of more goods than apparently necessary to be offered to insure satisfaction of the obligation is not commercially reasonable except in cases covered by the preceding sentence.

(2) A warehouseman's lien on goods other than goods stored by a merchant in the course of his business may be enforced only as follows:

(a) All persons known to claim an interest in the goods must be notified.

(b) The notification must be delivered in person or sent by registered or certified letter to the last known address of any person to be notified.

(c) The notification must include an itemized statement of the claim, a description of the goods subject to the lien, a demand for payment within a specified time not less than ten days after receipt of the notification, and a conspicuous statement that unless the claim is paid within that time the goods will be advertised for sale and sold by auction at a specified time and place.

(d) The sale must conform to the terms of the notification.

(e) The sale must be held at the nearest suitable place to that where the goods are held or stored.

(f) After the expiration of the time given in the notification, an advertisement of the sale must be published once a week for two weeks consecutively in a newspaper of general circulation where the sale is to be held. The advertisement must include a description of the goods, the name of the person on whose account they are being held, and the time and place of the sale. The sale must take place at least fifteen days after the first publication. If there is no newspaper of general circulation where the sale is to be held, the advertisement must be posted at least ten days before the sale in not less than six conspicuous places in the neighborhood of the proposed sale.

(3) Before any sale pursuant to this section any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred under this section. In that event the goods must not be sold, but must be retained by the warehouseman subject to the terms of the receipt and this article.

(4) The warehouseman may buy at any public sale pursuant to this section.

(5) A purchaser in good faith of goods sold to enforce a warehouseman's lien takes the goods free of any rights of persons against whom the lien was valid, despite noncompliance by the warehouseman with the requirements of this section.

(6) The warehouseman may satisfy his lien from the proceeds of any sale pursuant to this section but must hold the balance, if any, for delivery on demand to any person to whom he would have been bound to deliver the goods.

(7) The rights provided by this section shall be in addition to all other rights allowed by law to a creditor against his debtor.

(8) Where a lien is on goods stored by a merchant in the course of his business the lien may be enforced in accordance with either subsection (1) or (2).

(9) The warehouseman is liable for damages caused by failure to comply with the requirements for sale under this section and in case of willful violation is liable for conversion. (Rev., ss. 3036 to 3038, 3041; 1917, c. 37, ss. 32, 33, 35; C. S., ss. 4072, 4073, 4075; 1965, c. 700, s. 1.)



## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 33, Uniform Warehouse Receipts Act.

**Changes:** Rewritten; simplified foreclosure proceeding provided for all liens other than warehousemen's lien in non-commercial storage.

**Purposes of changes:**

1. Subsection (1) makes "commercial reasonableness" the standard for foreclosure proceedings in all cases except non-commercial storage with a warehouseman. The latter category embraces principally storage of household goods by private owners; and for such cases the detailed provisions as to notification, publication and public sale, found in Section 33 of the Uniform Warehouse Receipts Act, are retained in subsection (2). The swifter more flexible procedure of subsection (1) is appropriate to commercial storage. Compare seller's power of resale on breach by buyer under the provisions of the Article on Sales (Section 2—706).

2. The provisions of subsections (4) and (5) permitting the bailee to bid at public sales and confirming the title of purchasers at foreclosure sales are designed to secure more bidding and better prices.

**Cross reference:**

Section 7—403.

**Definitional cross references:**

"Bill of lading". Section 1—201.

"Conspicuous". Section 1—201.

"Creditor". Section 1—201.

"Delivery". Section 1—201.

"Document". Section 7—102.

"Good faith". Section 1—201.

"Goods". Section 7—102.

"Notification". Section 1—201.

"Notifies". Section 1—201.

"Person". Section 1—201.

"Purchaser". Section 1—201.

"Rights". Section 1—201.

"Term". Section 1—201.

"Warehouseman". Section 7—102.

## NORTH CAROLINA COMMENT

*Subsection (1):* This subsection is new. The idea explained in the Official Comment to subsection (1) allows a simpler method of enforcing the warehouseman's lien in the case of goods stored by a merchant. The new provisions specifically permit the sale to be "public or private." This subsection (1) requires that all persons known to claim an interest in the goods be notified, but the provision does not specifically require written notice. The implication of the second sentence is that it will be written.

*Subsection (2):* This subsection is similar to the prior law found in GS 27-37. UCC now allows notice by certified mail.

*Subsection (3):* This subsection is similar to GS 27-37 (3).

*Subsection (4):* This is new.

*Subsection (5):* This is new. See Official Comment.

*Subsection (6):* This is similar to the last sentence of GS 27-37 (2).

*Subsection (7):* This is similar to GS 27-36 and 27-39.

*Subsection (8):* This is new. Compare comments to subsections (1) and (2) in the Official Comment.

*Subsection (9):* This is new. However, under the cases, perhaps North Carolina would have held one who did not comply with the statute to be a converter. See *Elison v. Hunsinger*, 237 N.C. 619, 75 S.E.2d 540 (1953). The UCC makes a distinction between "a failure to comply" and "a willful violation."

## PART 3.

## BILLS OF LADING: SPECIAL PROVISIONS.

§ 25-7-301. Liability for non-receipt or misdescription; "said to contain"; "shipper's load and count"; improper handling.—(1) A consignee of a nonnegotiable bill who has given value in good faith or a holder to whom a negotiable bill has been duly negotiated relying in either case upon the description therein of the goods, or upon the date therein shown, may recover from the issuer damages caused by the misdating of the bill or the non-receipt or misdescription of the goods, except to the extent that the document indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, as where the description is in terms of marks or labels or kind, quantity, or condition or the receipt or description is qualified by "contents or condition of contents of packages unknown," "said to contain," "shipper's weight, load and count" or the like, if such indication be true.

(2) When goods are loaded by an issuer who is a common carrier, the issuer must count the packages of goods if package freight and ascertain the kind and quantity if bulk freight. In such cases "shipper's weight, load and count" or other words indicating that the description was made by the shipper are ineffective except as to freight concealed by packages.

(3) When bulk freight is loaded by a shipper who makes available to the issuer adequate facilities for weighing such freight, an issuer who is a common carrier must ascertain the kind and quantity within a reasonable time after receiving the written request of the shipper to do so. In such cases "shipper's weight" or other words of like purport are ineffective.

(4) The issuer may be [by] inserting in the bill the words "shipper's weight, load and count" or other words of like purport indicate that the goods were loaded by the shipper; and if such statement be true the issuer shall not be liable for damages caused by the improper loading. But their omission does not imply liability for such damages.

(5) The shipper shall be deemed to have guaranteed to the issuer the accuracy at the time of shipment of the description, marks, labels, number, kind, quantity, condition and weight, as furnished by him; and the shipper shall indemnify the issuer against damage caused by inaccuracies in such particulars. The right of the issuer to such indemnity shall in no way limit his responsibility and liability under the contract of carriage to any person other than the shipper. (1919, c. 65, ss. 20 to 22; C. S., ss. 302 to 304; 1965, c. 700, s. 1.)

**Editor's Note.** — The word "by" in brackets in subsection (4) is suggested as a correction of "be," which appears in the 1965 Session Laws.

**The former rule,** prior to the former Bills of Lading Act, was that when goods were sent "shipper's load and count," the bill of lading was only prima facie evidence that the carrier received the goods described in it, and where the evidence showed that the

loading was all done by the shipper, the burden was on the plaintiff to prove that the goods were actually delivered to the carrier. *Peele v. Atlantic Coast Line R.R.*, 149 N.C. 390, 63 S.E. 66 (1908). See *Williams, Black & Co. v. Wilmington & W.R.R.*, 93 N.C. 42 (1885); *Commercial Nat'l Bank v. Seaboard Air Line R.R.*, 175 N.C. 415, 95 S.E. 777 (1918).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 23, Uniform Bills of Lading Act.

**Changes:** Rewritten in part.

**Purposes of changes:**

1. The provision as to misdating in subsection (1) conforms to the policy of the amendment to the Federal Bills of Lading Act by 44 Stat. 1450 (1927), as amended 49 U.S.C. Section 102, after the holding in *Browne v. Union Pac. R. Co.*, 113 Kan. 726, 216 P. 299 (1923), affirmed on other grounds 267 U.S. 255, 45 S.Ct. 315, 69 L.Ed. 601 (1925). Subsections (2) and (3) conform to the policy of the Federal Bills of Lading Act, 49 U.S.C. Sections 100, 101, and the laws of several states. See e. g., N.Y.Pers.Prop. Law Section 209; Report of N. Y. Law Revision Commission, N.Y.Leg.Doc. (1941) No. 65(F).

2. The language of the old Uniform Act suggested that a carrier is ordinarily liable for damage caused by improper loading, but may relieve himself of liability by disclosing on the bill that shipper actually loaded. A more accurate statement of the law is that the carrier is not liable for

losses caused by act or default of the shipper, which would include improper loading. There is some question whether under present law a carrier is liable even to a good faith purchaser of a negotiable bill for such losses, if the shipper's faulty loading in fact caused the loss. It is this doubtful liability which subsection (4) permits the carrier to bar by disclosure of shipper's loading. There is no implication that decisions such as *Modern Tool Corp. v. Pennsylvania R. Co.*, 100 F. Supp. 595 (D.N.J.1951), are disapproved.

3. This section is a simplified restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor or shipper. The issuer is liable on documents issued by an agent, contrary to instructions of his principal, without receiving goods. No disclaimer of this liability is permitted since it is not a matter either of the care of the goods or their description.

4. The shipper's erroneous report to the

carrier concerning the goods may cause damage to the carrier. Subsection (5) therefore provides appropriate indemnity.

**Cross references:**

Sections 7—203 and 7—309.

**Definitional cross references:**

"Bill of lading". Section 1—201.

"Consignee". Section 7—102.

"Document". Section 7—102.

"Duly negotiate". Section 7—501.

"Good faith". Section 1—201.

"Goods". Section 7—102.

"Holder". Section 1—201.

"Issuer". Section 7—102.

"Notice". Section 1—201.

"Party". Section 1—201.

"Purchaser". Section 1—201.

"Receipt of goods". Section 2—103.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* Our prior law protected a "holder of an order bill." The UCC protects in a similar position a holder to whom a negotiable bill has been "duly negotiated." The UCC may be narrower than the prior law. Otherwise subsection (1) is similar to GS 21-22 and 21-23, except as to material about "misdating." See Official Comment.

*Subsection (2):* This subsection is similar to GS 21-21.

*Subsection (3):* Similar to GS 21-22.

*Subsection (4):* Similar to part of GS 21-22.

*Subsection (5):* This subsection is new. See Official Comment 4.

§ 25-7-302. Through bills of lading and similar documents.—(1) The issuer of a through bill of lading or other document embodying an undertaking to be performed in part by persons acting as its agents or by connecting carriers is liable to anyone entitled to recover on the document for any breach by such other persons or by a connecting carrier of its obligation under the document but to the extent that the bill covers an undertaking to be performed overseas or in territory not contiguous to the continental United States or an undertaking including matters other than transportation this liability may be varied by agreement of the parties.

(2) Where goods covered by a through bill of lading or other document embodying an undertaking to be performed in part by persons other than the issuer are received by any such person, he is subject with respect to his own performance while the goods are in his possession to the obligation of the issuer. His obligation is discharged by delivery of the goods to another such person pursuant to the document, and does not include liability for breach by any other such persons or by the issuer.

(3) The issuer of such through bill of lading or other document shall be entitled to recover from the connecting carrier or such other person in possession of the goods when the breach of the obligation under the document occurred, the amount it may be required to pay to anyone entitled to recover on the document therefor, as may be evidenced by any receipt, judgment, or transcript thereof, and the amount of any expense reasonably incurred by it in defending any action brought by anyone entitled to recover on the document therefor. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:**  
None.

**Purposes:**

1. The purpose of this section is to subject the initial carrier under a through bill to suit for breach of the contract of carriage by any connecting carrier and to make it clear that any such connecting carrier holds the goods on terms which are defined by the document of title even though such connecting carrier did not issue the document. Since the connecting carrier does hold on the terms of the document, it must honor a proper demand for

delivery or a diversion order just as the original bailee would have to. Similarly it has the benefits of the excuses for non-delivery and limitations of liability provided for the original bailee. Unlike the original bailee-issuer, the connecting carrier's responsibility is limited to the period while the goods are in its possession. The section is patterned generally after the Interstate Commerce Act, but does not impose any obligation to issue through bills.

2. The reference to documents other than through bills looks to the possibility that multi-purpose documents may come into



use, e. g., combination warehouse receipts and bills of lading.

3. Where the obligations or standards applicable to different parties bound by a document of title are different, the initial carrier's responsibility for portions of the journey not on its own lines will be determined by the standards appropriate to the connecting carrier. Thus a land carrier issuing a through bill of lading involving water carriage at a later stage will have the benefit of the water carrier's immunity from liability for negligence of its servants in navigating the vessel, where the law provides such an immunity for water carriers and the loss occurred while the goods were in the water carrier's possession.

4. Under Subsection (1) the issuer of a through bill of lading may become liable for the fault of another person. Subsection (3) gives it appropriate rights of recourse.

**Definitional cross references:**

"Agreement". Section 1—201.

"Bailee". Section 7—102.

"Bill of lading". Section 1—201.

"Delivery". Section 1—201.

"Document". Section 7—102.

"Goods". Section 7—102.

"Issuer". Section 7—102.

"Overseas". Section 2—323.

"Party". Section 1—201.

"Person". Section 1—201.

**NORTH CAROLINA COMMENT**

*Subsection (1):* Similar to GS 62-203, but prior law allowed the carrier to limit liability in certain instances.

*Subsection (2):* Similar to prior law.

See GS 62-203 and *Aydlett v. Norfolk So. R.R.*, 172 N.C. 47, 89 S.E. 1000 (1916).

*Subsection (3):* Similar to GS 62-203 after last proviso of subsection (a).

**§ 25-7-303. Diversion; reconsignment; change of instructions. —**

(1) Unless the bill of lading otherwise provides, the carrier may deliver the goods to a person or destination other than that stated in the bill or may otherwise dispose of the goods on instructions from

(a) the holder of a negotiable bill; or

(b) the consignor on a nonnegotiable bill notwithstanding contrary instructions from the consignee; or

(c) the consignee on a nonnegotiable bill in the absence of contrary instructions from the consignor, if the goods have arrived at the billed destination or if the consignee is in possession of the bill; or

(d) the consignee on a nonnegotiable bill if he is entitled as against the consignor to dispose of them.

(2) Unless such instructions are noted on a negotiable bill of lading, a person to whom the bill is duly negotiated can hold the bailee according to the original terms. (1919, c. 65, ss. 9, 10; C. S., ss. 291, 292; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. The old Acts contained no reference to diversion, a very common commercial practice which defeats delivery to the consignee originally named in a bill of lading. The carrier was protected under the heading of "justified delivery" if the substituted consignee who received delivery was "a person lawfully entitled to possession of the goods." Cf. subsection (1) (d). This in turn depended on whether the person ordering the diversion was the owner of the goods or empowered to dispose of them, which again might depend upon whether under sales law title had passed from the consignor-seller to the consignee-buyer. The carrier is plainly not in a position to decide such questions when directed by the person with whom it has

contracted for transportation to change the destination of the goods in transit. Carriers may as a business matter be willing to accept instructions from consignees in which case, as under the old uniform acts, the carrier will be liable for misdelivery if the consignee was not the owner or otherwise empowered to dispose of the goods. The section imposes no duty on carriers to undertake diversion; it is of course subject to the provisions of filed tariffs. Section 7—103.

2. It should be noted that the section provides only an immunity for carriers against liability for "misdelivery." It does not, for example, defeat the title to the goods which the consignee buyer may have acquired from the consignor-seller upon delivery of the goods to the carrier under a non-negotiable bill of lading. Thus if the carrier, upon instructions from the

consignor, returns the goods to him, the consignee may recover the goods from the consignor or his insolvent estate. However, under certain circumstances, the consignee's title may be defeated by diversion of the goods in transit to a different consignee.

**Cross references:**

Point 2: Sections 7—403 and 7—504(3).

**Definitional cross references:**

"Bailee". Section 7—102.

"Bill of lading". Section 1—201.

"Consignee". Section 7—102.

"Consignor". Section 7—102.

"Delivery". Section 1—201.

"Goods". Section 7—102.

"Holder". Section 1—201.

"Notice". Section 1—201.

"Person". Section 1—201.

"Purchaser". Section 1—201.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection is similar in part to GS 21-10 and 21-11. As to negotiable bills, the UCC does not change prior law, for it permits change of instructions to be made only by the holder and requires it to be noted on the bill as did

GS 21-10 (3). The prior law seemed to give consignee more power to give instructions, GS 21-10, than does the UCC. See GS 25-7-303 (1) (c).

*Subsection (2):* This subsection is new.

§ 25-7-304. **Bills of lading in a set.**—(1) Except where customary in overseas transportation, a bill of lading must not be issued in a set of parts. The issuer is liable for damages caused by violation of this subsection.

(2) Where a bill of lading is lawfully drawn in a set of parts, each of which is numbered and expressed to be valid only if the goods have not been delivered against any other part, the whole of the parts constitute one bill.

(3) Where a bill of lading is lawfully issued in a set of parts and different parts are negotiated to different persons, the title of the holder to whom the first due negotiation is made prevails as to both the document and the goods even though any later holder may have received the goods from the carrier in good faith and discharged the carrier's obligation by surrender of his part.

(4) Any person who negotiates or transfers a single part of a bill of lading drawn in a set is liable to holders of that part as if it were the whole set.

(5) The bailee is obligated to deliver in accordance with part 4 of this article against the first presented part of a bill of lading lawfully drawn in a set. Such delivery discharges the bailee's obligation on the whole bill. (1919, c. 65, s. 4; C. S., s. 286; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 6, Uniform Bills of Lading Act.

**Changes:** This section adds to existing legislation, which merely prohibits bills in a set in ordinary domestic trade, a statement of the legal effect of a lawfully issued set.

**Purposes of changes:**

The statement of the legal effect of a lawfully issued set is in accord with existing commercial law relating to maritime and other overseas bills. This law has been codified in the Hague and Warsaw Conventions and in the Carriage of Goods by Sea Act, the provisions of which would ordinarily govern in situations where bills in a set are recognized by this Article.

**Cross reference:**

Section 10—103.

**Definitional cross references:**

"Bailee". Section 7—102.

"Bill of lading". Section 7—102.

"Delivery". Section 1—201.

"Document". Section 7—102.

"Duly negotiate". Section 7—501.

"Good faith". Section 1—201.

"Goods". Section 7—102.

"Holder". Section 1—201.

"Issuer". Section 7—102.

"Overseas". Section 2—323.

"Person". Section 1—201.

"Receipt of goods". Section 2—103.

### NORTH CAROLINA COMMENT

The prior law applied to a negotiable bill of lading only when it involved transportation intrastate. GS 21-5. The UCC involves any bill of lading. The part of the

UCC setting out the effect of a bill of lading lawfully drawn in a set is new. That is, subsections (2), (3), (4), and (5) are new.

**§ 25-7-305. Destination bills.**—(1) Instead of issuing a bill of lading to the consignor at the place of shipment a carrier may at the request of the consignor procure the bill to be issued at destination or at any other place designated in the request.

(2) Upon request of anyone entitled as against the carrier to control the goods while in transit and on surrender of any outstanding bill of lading or other receipt covering such goods, the issuer may procure a substitute bill to be issued at any place designated in the request. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

This proposal is designed to facilitate the use of order bills in connection with fast shipments. Use of order bills on high speed shipments is impeded by the fact that the goods may arrive at destination before the documents, so that no one is ready to take delivery from the carrier. This is especially inconvenient for carriers by truck and air, who do not have terminal facilities where shipments can be held to await consignee's appearance. Order bills would be useful to take advantage of bank collection. This may be preferable to C.O.D. shipment in which the carrier, e. g. a truck driver, is the collecting and remitting agent. Financing of shipments under this plan would be handled as follows: seller at San Francisco delivers the goods to an airline with instructions to issue a bill in New York to a named bank.

Seller receives a receipt embodying this undertaking to issue a destination bill. Airline wires its New York freight agent to issue the bill as instructed by the seller. Seller wires the New York bank a draft on buyer. New York bank indorses the bill to buyer when he honors the draft. Normally seller would act through his own bank in San Francisco, which would extend him credit in reliance on the airline's contract to deliver a bill to the order of its New York correspondent. This section is entirely permissive; it imposes no duty to issue such bills. Whether a connecting carrier will act as issuing agent is left to agreement between carriers.

**Definitional cross references:**

"Bill of lading". Section 1—201.

"Consignor". Section 7—102.

"Goods". Section 7—102.

"Issuer". Section 7—102.

"Receipt of goods". Section 2—103.

**§ 25-7-306. Altered bills of lading.**—An unauthorized alteration or filling in of a blank in a bill of lading leaves the bill enforceable according to its original tenor. (1919, c. 65, s. 13; C. S., s. 295; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 16, Uniform Bills of Lading Act.

**Changes:** Generally revised and simplified; explicit treatment of the situation where a blank in an executed document is filled without authority.

**Purposes of changes:**

An unauthorized alteration whether made with or without fraudulent intent does not relieve the issuer of his liability on the document as originally executed. Uniform Warehouse Receipts Act 13 excused the issuer from any liability to a fraudulent alterer, other than the liability to deliver the goods according to the terms of the original document. It is difficult to conceive what liability the draftsman intended to excuse. Uniform Bills of Lading Act 16 contains no such excuse

provision, and is followed in this respect in the present section. Uniform Bills of Lading Act 16 characterizes an unauthorized alteration as "void" but apparently nothing more was intended than that the alteration did not change the obligation of the issuer. This is sufficiently covered by the terms of this section. Moreover cases are conceivable in which an alteration would not be "void"; for example, an alteration made by common consent of a transferor and transferee of a document might evidence an enforceable contract between them. The same rule is made applicable to the filling in of blanks, a matter on which the prior Acts were silent.

**Definitional cross references:**

"Bill of lading". Section 1—201.

"Issuer". Section 7—102.

#### NORTH CAROLINA COMMENT

This is similar to GS 21-14.



§ 25-7-307. **Lien of carrier.**—(1) A carrier has a lien on the goods covered by a bill of lading for charges subsequent to the date of its receipt of the goods for storage or transportation (including demurrage and terminal charges) and for expenses necessary for preservation of the goods incident to their transportation or reasonably incurred in their sale pursuant to law. But against a purchaser for value of a negotiable bill of lading a carrier's lien is limited to charges stated in the bill or the applicable tariffs, or if no charges are stated then to a reasonable charge.

(2) A lien for charges and expenses under subsection (1) on goods which the carrier was required by law to receive for transportation is effective against the consignor or any person entitled to the goods unless the carrier had notice that the consignor lacked authority to subject the goods to such charges and expenses. Any other lien under subsection (1) is effective against the consignor and any person who permitted the bailor to have control or possession of the goods unless the carrier had notice that the bailor lacked such authority.

(3) A carrier loses his lien on any goods which he voluntarily delivers or which he unjustifiably refuses to deliver. (1919, c. 65, s. 25; C. S., s. 307; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 27 through 32, Uniform Warehouse Receipts Act.

**Changes:** Rewritten; lien extended to carrier. Lien of common carrier validated unless carrier had notice that consignor lacked authority to subject the goods to charges and expenses. Where the carrier is not required by law to receive the goods for transportation, lien validated against anyone who permitted the bailor to have possession even if he had no real or apparent authority.

##### Purposes of Changes:

The section is intended to give carriers a specific statutory lien for charges and expenses similar to that given to warehousemen by the first sentence of Section 7—209. But since carriers do not commonly claim a lien for charges in relation to other goods or lend money on the security of goods in their hands, provisions for a general lien or a security interest similar to those in Section 7—209(1) and (2) are omitted. See Comment to Section 7—105.

Since the lien given by this section is specific, and the storage or transportation often preserves or increases the value of the goods, subsection (2) validates the lien against anyone who permitted the bailor to have possession of the goods. Where the carrier is required to receive the goods for transportation, the owner's interest may be subjected to charges and expenses arising out of deposit of his goods by a thief. Cf. Section 9—310. The crucial mental element is the carrier's knowledge or reason to know of the bailor's lack of authority.

##### Cross references:

Sections 7—209, 9—102(2) and 9—310.

##### Definitional cross references:

"Bill of lading". Section 1—201.

"Consignor". Section 7—102.

"Delivery". Section 1—201.

"Goods". Section 7—102.

"Person". Section 1—201.

"Purchaser". Section 1—201.

"Value". Section 1—201.

#### NORTH CAROLINA COMMENT

*Subsection (1):* The prior law expressly recognized the existence of a carrier's lien on goods shipped under a negotiable bill of lading. GS 21-26. A carrier's lien as to a nonnegotiable bill of lading was not expressly set out. See *Hammer Lumber Co. v. Seaboard Air Line Ry.*, 179 N.C. 359, 102 S.E. 508 (1920), involving a lien on a nonnegotiable bill of lading.

*Subsection (2):* This subsection is new.

*Subsection (3):* This subsection is new. Compare with GS 25-7-209. However, this subsection is in accord with common-law rule. See discussion of possessory lien in *Barbree-Askew Fin., Inc. v. Thompson*, 247 N.C. 143, 100 S.E.2d 381 (1957).

§ 25-7-308. **Enforcement of carrier's lien.**—(1) A carrier's lien may be enforced by public or private sale of the goods, in bloc or in parcels, at any time or place and on any terms which are commercially reasonable, after notifying all persons known to claim an interest in the goods. Such notification must include a statement of the amount due, the nature of the proposed sale and the time and

place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the carrier is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the carrier either sells the goods in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with commercially reasonable practices among dealers in the type of goods sold he has sold in a commercially reasonable manner. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable except in cases covered by the preceding sentence.

(2) Before any sale pursuant to this section any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred under this section. In that event the goods must not be sold, but must be retained by the carrier subject to the terms of the bill and this article.

(3) The carrier may buy at any public sale pursuant to this section.

(4) A purchaser in good faith of goods sold to enforce a carrier's lien takes the goods free of any rights of persons against whom the lien was valid, despite noncompliance by the carrier with the requirements of this section.

(5) The carrier may satisfy his lien from the proceeds of any sale pursuant to this section but must hold the balance, if any, for delivery on demand to any person to whom he would have been bound to deliver the goods.

(6) The rights provided by this section shall be in addition to all other rights allowed by law to a creditor against his debtor.

(7) A carrier's lien may be enforced in accordance with either subsection (1) or the procedure set forth in subsection (2) of § 25-7-210.

(8) The carrier is liable for damages caused by failure to comply with the requirements for sale under this section and in case of willful violation is liable for conversion. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 33, Uniform Warehouse Receipts Act.

**Changes:** Rewritten; provisions extended to carriers' liens; simplified foreclosure proceeding provided.

##### **Purposes of changes:**

This section is intended to give the carrier an enforcement procedure of his lien coextensive with that given the warehousemen in cases other than those covering noncommercial storage by him. See Comment to Section 7-210.

##### **Cross reference:**

Section 7-210.

##### **Definitional cross references:**

"Bill of lading" Section 1-201.

"Creditor". Section 1-201.

"Delivery". Section 1-201.

"Good faith". Section 1-201.

"Goods". Section 7-102.

"Notification". Section 1-201.

"Notifies". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Rights". Section 1-201.

"Term". Section 1-201.

#### NORTH CAROLINA COMMENT

This section specifically sets out the method of satisfying the lien. This is new for the most part. Compare with GS 25-7-

210. Compare also with GS 62-209, which provides for the sale of unclaimed baggage or freight.

**§ 25-7-309. Duty of care; contractual limitation of carrier's liability.**—(1) A carrier who issues a bill of lading whether negotiable or nonnegotiable must exercise the degree of care in relation to the goods which a reasonably careful man would exercise under like circumstances. This subsection does not repeal or change any law or rule of law which imposes liability upon a common carrier for damages not caused by its negligence.

(2) Damages may be limited by a provision that the carrier's liability shall not exceed a value stated in the document if the carrier's rates are dependent upon value and the consignor by the carrier's tariff is afforded an opportunity to declare

a higher value or a value as lawfully provided in the tariff, or where no tariff is filed he is otherwise advised of such opportunity; but no such limitation is effective with respect to the carrier's liability for conversion to its own use.

(3) Reasonable provisions as to the time and manner of presenting claims and instituting actions based on the shipment may be included in a bill of lading or tariff. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 3, Uniform Bills of Lading Act.

**Changes:** Consolidated and rewritten.

#### Purposes of changes:

The old uniform act provided that bills of lading could not contain terms impairing the obligation of reasonable care. Whether this is violated by a stipulation that in case of loss the bailee's liability is limited to stated amounts has been much controverted. For interstate rail transportation the matter is settled by the Carmack Amendment to the Interstate Commerce Act (See 49 U.S.C.A. § 20(11)). The present section is a generalized version of the Interstate Commerce Act provisions. The obligation of due care is radically qualified, in the case of maritime bills and international airbills, by federal legislation and treaty. All this special legislation would remain in effect even if Congress enacts this Code, including the present Article. See Section 7-103.

Subsection (1) does not impair any rule

of law imposing the liability of an insurer on a common carrier in intrastate commerce. Subsection (2), however, applies to such liability as well as to liability based on negligence. The entire section is subject under Section 7-103 to applicable provisions in filed tariffs, such as the common disclaimer of responsibility for undeclared articles of extraordinary value, hidden from view. Tariffs which lawfully provide a maximum unit value beyond which goods are not taken fall within the same principle, and are expressly covered by the words "value as lawfully provided in the tariff."

#### Cross reference:

Section 7-103.

#### Definitional cross references:

"Action". Section 1-201.

"Bill of lading". Section 1-201.

"Consignor". Section 7-102.

"Document". Section 7-102.

"Goods". Section 7-102.

"Value". Section 1-201.

#### NORTH CAROLINA COMMENT

*Subsection (1):* Other law may require a higher degree of care. See GS 62-203 (a).

*Subsection (2):* Similar to GS 62-203 (a).

*Subsection (3):* This subsection is new.

### PART 4.

#### WAREHOUSE RECEIPTS AND BILLS OF LADING: GENERAL OBLIGATIONS.

§ 25-7-401. Irregularities in issue of receipt or bill or conduct of issuer.—The obligations imposed by this article on an issuer apply to a document of title regardless of the fact that

(a) the document may not comply with the requirements of this article or of any other law or regulation regarding its issue, form or content; or

(b) the issuer may have violated laws regulating the conduct of his business; or

(c) the goods covered by the document were owned by the bailee at the time the document was issued; or

(d) the person issuing the document does not come within the definition of warehouseman if it purports to be a warehouse receipt. (1917, c. 37, s. 20; 1919, c. 65, ss. 21, 22; C. S., ss. 303, 304, 4060; 1931, c. 358, s. 1; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 20, Uniform Warehouse Receipts Act; Section 23, Uniform Bills of Lading Act.

**Changes:** Most of the material is new; the uniform act sections cited deal only with non-receipt and misdescription.

#### Purposes of changes and new matter:

The bailee's liability on his document despite non-receipt or misdescription of the goods is affirmed in Sections 7-203 and 7-301. The purpose of this section is to make it clear that regardless of irregu-



larities a document which falls within the definition of document of title imposes on the issuer the obligations stated in this Article. For example, a bailee will not be permitted to avoid his obligation to deliver the goods (Section 7-403) or his obligation of due care with respect to them (Sections 7-204 and 7-309) by taking the position that no valid "document" was issued because he failed to file a statutory bond or did not pay stamp taxes or did not disclose the place of storage in the document. Sanctions against violations of statutory or administrative duties with respect to documents should be limited to revocation of license or other measures prescribed by the regulation imposing the

duty. As to the continuing vitality of regulations, in addition to those found in this Article, of documents of title, see Sections 7-103 and 10-103.

**Cross references:**

Sections 7-103, 7-203, 7-204, 7-301, 7-309 and 10-103.

**Definitional cross references:**

"Bailee". Section 7-102.

"Document". Section 7-102.

"Document of title". Section 1-201.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Person". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouseman". Section 7-102.

### NORTH CAROLINA COMMENT

This whole section is, for the most part, new. The law was similar in respect to misdescription in GS 21-22, 21-23 and 27-24.

§ 25-7-402. **Duplicate receipt or bill; overissue.**—Neither a duplicate nor any other document of title purporting to cover goods already represented by an outstanding document of the same issuer confers any right in the goods, except as provided in the case of bills in a set, overissue of documents for fungible goods and substitutes for lost, stolen or destroyed documents. But the issuer is liable for damages caused by his overissue or failure to identify a duplicate document as such by conspicuous notation on its face. (1917, c. 37, s. 6; 1919, c. 65, s. 5; C. S., ss. 287, 4047; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 6, Uniform Warehouse Receipts Act; Section 7, Uniform Bills of Lading Act.

**Changes:** Consolidated and rewritten.

**Purposes of changes:**

1. This section treats a duplicate which is not properly identified as such like any other overissue of documents: a purchaser of such a document acquires no title but only a cause of action for damages against the person who made his deception possible, except in the cases noted in the section. But parts of a bill lawfully issued in a set of parts are not "overissue" (Section 7-304). Of course, if the issuer has clearly indicated that a document is a duplicate so that no one can be deceived by it, and in fact the duplicate is a correct copy of the original, the warehouseman is not liable for preparing and delivering such a duplicate copy.

2. The section applies to nonnegotiable documents to the extent of providing an action for damages for one who acquires an unmarked duplicate from a transferor who knew the facts and would therefore himself have had no cause of action against the issuer of the duplicate. Ordinarily the transferee of a nonnegotiable

document acquires only the rights of his transferor.

3. Overissue is defined so as to exclude the common situation where two valid documents of different issuers are outstanding for the same goods at the same time. Thus freight forwarders commonly issue bills of lading to their customers for small shipments to be combined into carload shipments for which the railroad will issue a bill of lading to the forwarder. So also a warehouse receipt may be outstanding against goods, and the holder of the receipt may issue delivery orders against the same goods. In these cases dealings with the subsequently issued documents may be effective to transfer title; e. g. negotiation of a delivery order will effectively transfer title in the ordinary case where no dishonesty has occurred and the goods are available to satisfy the orders. Section 7-503 provides for cases of conflict between documents of different issuers.

**Cross references:**

Point 1: Sections 7-207, 7-304, and 7-601.

Point 3: Section 7-503.

**Definitional cross references:**

"Bill of lading". Section 1—201.

"Conspicuous". Section 1—201.

"Document". Section 7—102.

"Document of title". Section 1—201.

"Fungible" goods. Section 1—201.

"Goods". Section 7—102.

"Issuer". Section 7—102.

"Right". Section 1—201.

**NORTH CAROLINA COMMENT**

This section extends GS 21-6 and 27-11, documents, so that issuers of unmarked which applied only to duplicate negotiable nonnegotiable documents also are covered.

**§ 25-7-403. Obligation of warehouseman or carrier to deliver; excuse.**—(1) The bailee must deliver the goods to a person entitled under the document who complies with subsections (2) and (3), unless and to the extent that the bailee establishes any of the following:

(a) delivery of the goods to a person whose receipt was rightful as against the claimant;

(b) damage to or delay, loss or destruction of the goods for which the bailee is not liable, but the burden of establishing negligence in such cases is on the person entitled under the document;

(c) previous sale or other disposition of the goods in lawful enforcement of a lien or on warehouseman's lawful termination of storage;

(d) the exercise by a seller of his right to stop delivery pursuant to the provisions of the article on sales (§ 25-2-705);

(e) a diversion, reconsignment or other disposition pursuant to the provisions of this article (§ 25-7-303) or tariff regulating such right;

(f) release, satisfaction or any other fact affording a personal defense against the claimant;

(g) any other lawful excuse.

(2) A person claiming goods covered by a document of title must satisfy the bailee's lien where the bailee so requests or where the bailee is prohibited by law from delivering the goods until the charges are paid.

(3) Unless the person claiming is one against whom the document confers no right under § 25-7-503 (1), he must surrender for cancellation or notation of partial deliveries any outstanding negotiable document covering the goods, and the bailee must cancel the document or conspicuously note the partial delivery thereon or be liable to any person to whom the document is duly negotiated.

(4) "Person entitled under the document" means holder in the case of a negotiable document, or the person to whom delivery is to be made by the terms of or pursuant to written instructions under a nonnegotiable document. (1917, c. 37, ss. 8, 9, 11, 12, 36; 1919, c. 65, ss. 8, 9, 11, 12, 26; C. S., ss. 290, 291, 293, 294, 308, 4048, 4049, 4051, 4052, 4076; 1965, c. 700, s. 1.)

**Editor's Note.**—This section includes the optional language in subsection (1) (b) discussed in Official Comment 3 and the North Carolina Comment.

**Consignee Must Produce Bill on Demand.**—The failure or refusal of consignee to produce, upon the carrier's demand, a bill of lading for a prepaid shipment of goods in the carrier's possession is ordinarily a valid defense to an action to recover of the carrier the value of a shipment, which has never been delivered, but the burden is upon the carrier to prove that such demand has been made and not complied with. *Jeans v. Seaboard Air Line R.R.*, 164 N.C. 224, 80 S.E. 242 (1913).

**Possession of Bill Is Sufficient Evidence of Ownership.**—An order bill of lading indorsed by the shipper, in the possession of the plaintiff, is sufficient evidence of the plaintiff's ownership of the bill and of the goods for which the bill was issued. *Temple v. Southern R.R.*, 190 N.C. 439, 129 S.E. 815 (1925).

**If It Is Indorsed.**—Where shipper paid the draft and obtained the bill of lading but failed to have it indorsed by a certain bank as required by the terms of the bill, the carrier was not liable for failure to deliver the goods. *Killingsworth v. Norfolk So. R.R.*, 171 N.C. 47, 87 S.E. 947 (1916).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 8 through 12, 16 and 19, Uniform Warehouse Receipts Act; Sections 11 through 15, 19 and 22, Uniform Bills of Lading Act.

**Changes:** Consolidated and rewritten.

**Purposes of changes:**

1. The general and primary purpose of this revision is to simplify the statement of the bailee's obligation on the document. The interrelations of the separate sections of the old uniform acts dealing with "obligation to deliver," "justification in delivering," and "liability for misdelivery" are obscure. The present section is constructed on the basis of stating what previous deliveries or other circumstances operate to excuse the bailee's normal obligation on the document. Accordingly, "justified" deliveries under the old uniform acts now find their place as "excuse" under subsection (1). Unjustified deliveries, i.e., "misdeliveries" under the old acts, are simply omitted from the list of excuses thus permitting the normal obligation on the document to be asserted.

2. The principal case covered by subsection (1) (a) is delivery to a person whose title is paramount to the rights represented by the document. For example, if a thief deposits stolen goods in a warehouse and takes a negotiable receipt, the warehouseman is not liable on the receipt if he has surrendered the goods to the true owner, even though the receipt is held by a good faith purchaser. See Section 7-503(1). However, if the owner entrusted the goods to a person with power of disposition, and that person deposited the goods and took a negotiable document, the owner's receipt would not be rightful as against a holder to whom the negotiable document was duly negotiated and delivery to the owner would not give the bailee a defense against such a holder. See Sections 7-502(1)(b), 7-503(1)(a).

3. Subsection (1) (b) amounts to a cross reference to all the tort law that determines the varying responsibilities and standards of care applicable to commercial bailees. A restatement of this tort law would be beyond the scope of this Act. Much of the applicable law as to responsibility of bailees for the preservation of the goods and limitation of liability in case of loss has been codified for particular classes of bailees in interstate and foreign commerce by federal legislation and treaty and for intrastate carriers and other bailees by

the regulatory state laws preserved by Section 7-103. In the absence of governing legislation the common law will prevail subject to the minimum standard of reasonable care prescribed by Sections 7-204 and 7-309 of this Article. The optional language in subsection (1)(b) states the rule laid down for interstate carriers in many federal cases. State decisions are in conflict as to both carriers and warehousemen. Particular states may prefer to adopt the federal rule.

4. Subsection (2) eliminates the implication of the old uniform acts that a request for delivery must be accompanied by a formal tender of the amount of the charges due. Rather, the bailee must request payment of the amount of his lien when asked to deliver, and only in case this request is refused is he justified in declining to deliver because of nonpayment of charges. Where delivery without payment is forbidden by law, the request is treated as implicit. Such a prohibition reflects a policy of uniformity to prevent discrimination by failure to request payment in particular cases.

5. Subsection (3) states the obvious duty of a bailee to take up a negotiable document or note partial deliveries conspicuously thereon, and the result of failure in that duty. It is subject to only one exception, that stated in subsection 1(a) of this section and in Section 7-503(1). It is limited to cases of delivery to a claimant; it has no application, for example, where goods held under a negotiable document are lawfully sold to enforce the bailee's lien.

**Cross references:**

Point 2: Sections 7-502 and 7-503.

Point 3: Sections 7-103, 7-204, 7-309 and 10-103.

Point 5: Section 7-503(1).

**Definitional cross references:**

"Bailee". Section 7-102.

"Conspicuous". Section 1-201.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Document of title". Section 1-201.

"Duly negotiate". Section 7-501.

"Goods". Section 7-102.

"Person". Section 1-201.

"Receipt of goods". Section 2-103.

"Right". Section 1-201.

"Terms". Section 1-201.

"Warehouseman". Section 7-102.

"Written". Section 1-201.

## NORTH CAROLINA COMMENT

*Subsection (1):* Under GS 21-9 and 27-12 the bailee was under a duty to deliver

the goods to the person entitled to them under the document of title "in the absence



of some lawful excuse." This subsection clarifies what constitutes a "lawful excuse."

(a) Similar to GS 21-10 and 27-13.

(b) The optional part of this paragraph seems to be the same as prior law. See Stansbury, *The North Carolina Law of Evidence* § 226 (2d ed. 1963); *Millers Mutual Ins. Ass'n v. Atkinson Motors*, 240 N.C. 183, 81 S.E.2d 416 (1954). In this case, the court says, "under these circumstances, the defendant's possession and control was that of bailee, under a bailment for the mutual benefit of the bailor and bailee; and in such case the duty of the bailee is to exercise due care and his liability depends upon the presence or absence of ordinary negligence."

(c) Similar in effect to GS 21-27 and 27-40.

**§ 25-7-404. No liability for good faith delivery pursuant to receipt or bill.**—A bailee who in good faith including observance of reasonable commercial standards has received goods and delivered or otherwise disposed of them according to the terms of the document of title or pursuant to this article is not liable therefor. This rule applies even though the person from whom he received the goods had no authority to procure the document or to dispose of the goods and even though the person to whom he delivered the goods had no authority to receive them. (1917, c. 37, s. 10; 1919, c. 65, s. 10; C. S., ss. 292, 4050; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 10, Uniform Warehouse Receipts Act; Section 13, Uniform Bills of Lading Act.

**Changes:** Consolidated and rewritten.

**Purposes of changes:**

The generalized test of good faith and observance of reasonable commercial standards is substituted for the attempts to particularize what constitutes good faith in the cited sections of the old uniform acts. The section states explicitly what is perhaps an implication from the old acts that the common law rule of "innocent conversion" by unauthorized "intermeddling" with another's property is inapplicable to the operations of commercial carriers and warehousemen, who in good faith and with

(d) Similar to prior law in part. GS 21-9 permitted excuse for failure to deliver when justified, and the cases permitted a stoppage in transit. *Farrell & Co. v. Richmond & D. R.R.*, 102 N.C. 390, 9 S.E. 302 (1889).

(e) See North Carolina Comment to GS 25-7-303.

(f) GS 21-9 began by saying that goods must be delivered "in the absence of some lawful excuse," as did GS 27-12.

(g) See comment to (f) above.

*Subsection (2):* Similar to GS 21-9 (1) and 27-12 (1).

*Subsection (3):* Similar to GS 21-12 and 21-13 and also GS 27-15 and 27-16.

*Subsection (4):* Similar to GS 21-10, 27-13.

reasonable observance of commercial standards perform obligations which they have assumed and which generally they are under a legal compulsion to assume. The section applies to delivery to a fraudulent holder of a valid document as well as to delivery to the holder of an invalid document.

**Definitional cross references:**

"Bailee". Section 7—102.

"Delivery". Section 1—201.

"Document of title". Section 1—201.

"Good faith". Section 1—201.

"Goods". Section 7—102.

"Person". Section 1—201.

"Receipt of goods". Section 2—103.

"Term". Section 1—201.

#### NORTH CAROLINA COMMENT

This is a rewriting of GS 21-11 and 27-14. See Official Comment. It may give a little more protection for delivery to one who is not owner than the prior law. In an action by the true owner, GS 25-7-404 gives

the bailee a defense if he has delivered "according to the terms of the document," but only if he acts "in good faith including observance of reasonable commercial standards."

### PART 5.

#### WAREHOUSE RECEIPTS AND BILLS OF LADING: NEGOTIATION AND TRANSFER.

**§ 25-7-501. Form of negotiation and requirements of "due negotiation."**—(1) A negotiable document of title running to the order of a named per-

son is negotiated by his indorsement and delivery. After his indorsement in blank or to bearer any person can negotiate it by delivery alone.

(2) (a) A negotiable document of title is also negotiated by delivery alone when by its original terms it runs to bearer.

(b) When a document running to the order of a named person is delivered to him the effect is the same as if the document had been negotiated.

(3) Negotiation of a negotiable document of title after it has been indorsed to a specified person requires indorsement by the special indorsee as well as delivery.

(4) A negotiable document of title is "duly negotiated" when it is negotiated in the manner stated in this section to a holder who purchases it in good faith without notice of any defense against or claim to it on the part of any person and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a money obligation.

(5) Indorsement of a nonnegotiable document neither makes it negotiable nor adds to the transferee's rights.

(6) The naming in a negotiable bill of a person to be notified of the arrival of the goods does not limit the negotiability of the bill nor constitute notice to a purchaser thereof of any interest of such person in the goods. (1917, c. 37, ss. 37 to 40, 47; 1919, c. 65, ss. 3, 7, 27 to 30, 37; C. S., ss. 285, 289, 309 to 312, 319, 4077 to 4080, 4087; 1931, c. 358, ss. 2, 3; 1965, c. 700, s. 1.)

**Indorsed Warehouse Receipts Are Negotiable by Delivery.**—Warehouse receipts, indorsed by the owner of the cotton and by the superintendent of the warehouse, are negotiable by delivery, and when taken as

collateral confer upon the holder the position of a bona fide holder for value. *Lacy v. Globe Indem. Co.*, 189 N.C. 24, 126 S.E. 316 (1925).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 28, 29, 31, 32 and 38, Uniform Sales Act; Sections 37, 38, 39, 40 and 47, Uniform Warehouse Receipts Act; Sections 28, 29, 30, 31 and 38, Uniform Bills of Lading Act.

**Changes:** Consolidated and rewritten.

**Purposes of changes:**

1. In general this section is intended to clarify the language of the old acts and to restate the effect of the better decisions thereunder. An important new concept is added, however, in the requirement of "regular course of business or financing" to effect the "due negotiation" which will transfer greater rights than those held by the person negotiating. The foundation of the mercantile doctrine of good faith purchase for value has always been, as shown by the case situations, the furtherance and protection of the regular course of trade. The reason for allowing a person, in bad faith or in error, to convey away rights which are not his own has from the beginning been to make possible the speedy handling of that great run of commercial transactions which are patently usual and normal.

There are two aspects to the usual and normal course of mercantile dealings, namely, the person making the transfer and the nature of the transaction itself.

The first question which arises is: Is the transferor a person with whom it is reasonable to deal as having full powers? In regard to documents of title the only holder whose possession appears, commercially, to be in order is almost invariably a person in the trade. No commercial purpose is served by allowing a tramp or a professor to "duly negotiate" an order bill of lading for hides or cotton not his own, and since such a transfer is obviously not in the regular course of business, it is excluded from the scope of the protection of subsection (4).

The second question posed by the "regular course" qualification is: Is the transaction one which is normally proper to pass full rights without inquiry, even though the transferor himself may not have such rights to pass, and even though he may be acting in breach of duty? In raising this question the "regular course" criterion has the further advantage of limiting the effective wrongful disposition to transactions whose protection will really further trade. Obviously, the snapping up of goods for quick resale at a price suspiciously below the market deserves no protection as a matter of policy, it is also clearly outside the range of regular course.

Any notice from the face of the document sufficient to put a merchant on in-

quiry as to the "regular course" quality of the transaction will frustrate a "due negotiation". Thus irregularity of the document on its face or unexplained staleness of a bill of lading may appropriately be recognized as negating a negotiation in "regular" course.

A pre-existing claim constitutes value, and "due negotiation" does not require "new value." A usual and ordinary transaction in which documents are received as security for credit previously extended may be in "regular" course, even though there is a demand for additional collateral because the creditor "deems himself insecure." But the matter has moved out of the regular course of financing if the debtor is thought to be insolvent the credit previously extended is in effect cancelled, and the creditor snatches a plank in the shipwreck under the guise of a demand for additional collateral. Where a money debt is "paid" in commodity paper, any question of "regular" course disappears, as the case is explicitly excepted from "due negotiation".

2. Negotiation under this section may be made by any holder no matter how he acquired possession of the document. The present section follows in this respect the Uniform Bills of Lading Act and amendments of the original Uniform Sales Act and Uniform Warehouse Receipts Act proposed by the Commissioners on Uniform State Laws in 1922.

3. Subsection (2) (b) makes explicit a matter upon which the intent of the old acts was clear but the language somewhat obscure: a negotiation results from a de-

livery to a banker or buyer to whose order the document has been taken by the person making the bailment. There is no presumption of irregularity in such a negotiation; it may very well be in "regular course."

4. This Article does not contain any provision creating a presumption of due negotiation to, and full rights in, a holder of a document of title akin to that created by Sections 16, 24 and 59 of the Negotiable Instrument Law. But the reason of the provisions of this Act (Section 1—202) on the prima facie authenticity and accuracy of third party documents, joins with the reason of the present section to work such a presumption in favor of any person who has power to make a due negotiation. It would not make sense for this Act to authorize a purchase to indulge the presumption of regularity if the courts were not also called upon to do so.

#### Cross references:

Point 1: Sections 7—502 and 7—503.

Point 2: Section 7—502.

#### Definitional cross references:

"Bearer". Section 1—201.

"Delivery". Section 1—201.

"Document". Section 7—102.

"Document of title". Section 1—201.

"Good faith". Section 1—201.

"Holder". Section 1—201.

"Notice". Section 1—201.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Rights". Section 1—201.

"Term". Section 1—201.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* This is substantially a restatement of GS 21-28 and 21-29 and GS 27-41 and 27-42.

*Subsection (2):* (a) This is a restatement of GS 21-28 and 27-41 (1), except to the extent that GS 21-3 did not mention "bearer" documents.

(b) According to the Official Comment 3, this paragraph expresses what is implicit in GS 21-23 and 21-29 and GS 27-41 and 27-42.

*Subsection (3):* This is substantially a rephrasing of GS 21-29 and 27-42.

*Subsection (4):* This is substantially a rewriting of GS 21-31 and 21-38 and GS

27-44 and 27-51. The language "unless it is established that the negotiation is not in the regular course of business" is new unless the requirement of good faith would require negotiation "in the regular course of business." See *Locke Cotton Mills v. Pate Cotton Co.*, 232 N.C. 186, 59 S.E.2d 570 (1950).

*Subsection (5):* This subsection is substantially a rephrasing of GS 21-30 and 27-43.

*Subsection (6):* This is similar to GS 21-8.

**§ 25-7-502. Rights acquired by due negotiation.**—(1) Subject to the following section [§ 25-7-503] and to the provisions of § 25-7-205 on fungible goods, a holder to whom a negotiable document of title has been duly negotiated acquires thereby:

- (a) title to the document;
- (b) title to the goods;



(c) all rights accruing under the law of agency or estoppel, including rights to goods delivered to the bailee after the document was issued; and

(d) the direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defense or claim by him except those arising under the terms of the document or under this article. In the case of a delivery order the bailee's obligation accrues only upon acceptance and the obligation acquired by the holder is that the issuer and any indorser will procure the acceptance of the bailee.

(2) Subject to the following section [§ 25-7-503], title and rights so acquired are not defeated by any stoppage of the goods represented by the document or by surrender of such goods by the bailee, and are not impaired even though the negotiation or any prior negotiation constituted a breach of duty or even though any person has been deprived of possession of the document by misrepresentation, fraud, accident, mistake, duress, loss, theft or conversion, or even though a previous sale or other transfer of the goods or document has been made to a third person. (1917, c. 37, ss. 41, 47 to 49; 1919, c. 65, ss. 31, 37 to 39; C. S., ss. 313, 319 to 321, 4081, 4087 to 4089; 1931, c. 358, s. 3; 1965, c. 700, s. 1.)

**Indorsee of Bill of Lading May Recover for Damage to Goods before Negotiation.**—

The person to be notified on shipment to order of consignor had title for the purpose of a suit to recover damages and the statutory penalty, as fully as if the carrier had contracted with him direct, upon the presentation of the bill of lading properly indorsed and his tender thereof in good faith to the carrier, the Bills of Lading Act being remedial of the common law that there was no contractual relation between him and the carrier that would permit recovery for causes accruing before he had paid the draft, and had the bill of lading assigned to him. *Watts v. Norfolk So. Ry.*, 183 N.C. 12, 110 S.E. 582 (1922).

The negotiation of a warehouse receipt is not impaired by the fact that such negotiation was a breach of duty on the part of the person making the negotiation, if the person to whom the receipt was nego-

tiated took same for value, in good faith, and without notice of the breach of duty. *Harris v. Fairley*, 232 N.C. 551, 61 S.E.2d 616 (1950). See *Lacy v. Globe Indem. Co.*, 189 N.C. 24, 126 S.E. 316 (1925).

**Instruction Omitting Element of Transferee's "Good Faith" Held Erroneous.**—

An instruction to the effect that the burden is upon the transferee to show that he took the warehouse receipts in controversy for value and without notice of any defect, must be held to be reversible error for omitting the element of good faith, notwithstanding a prior correct instruction, when the question of good faith is the focal point of the controversy upon plaintiff's evidence that the transferor was its agent and transferred the receipts in discharge of his personal liability to the transferee on an unpaid check. *Locke Cotton Mills Co. v. Pate Cotton Co.*, 232 N.C. 186, 59 S.E.2d 570 (1950).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 20(4), 25, 33, 38 and 62, Uniform Sales Act; Sections 41, 47, 48 and 49, Uniform Warehouse Receipts Act; Sections 32, 38, 39, 40 and 42, Uniform Bills of Lading Act.

**Changes:** Rewritten.

**Purposes of Changes:**

1. The several necessary qualifications of the broad principle that the holder of a document acquired in a due negotiation is the owner of the document and the goods have been brought together in the next section.

2. Subsection (1) (c) covers the case of "feeding" of a duly negotiated document by subsequent delivery to the bailee of such goods as the document falsely purported to cover; the bailee in such case is

estopped as against the holder of the document.

3. The explicit statement in subsection (1) (d) of the bailee's direct obligation to the holder precludes the defense, sometimes successfully asserted under the old acts, that the document in question was "spent" after the carrier had delivered the goods to a previous holder. But the holder is subject to such defenses as non-negligent destruction even though not apparent on the face of the document, and the bailee's obligation is of course subject to lawful provisions in filed classifications and tariffs. See Sections 7—103, 7—403. The sentence on delivery orders applies only to delivery orders in negotiable form which have been duly negotiated. On delivery orders, see also Section 7—503(2) and Comment.

4. Subsection (2) condenses and continues the law of a number of sections of the prior acts which gave full effect to the issuance or due negotiation of a negotiable document. The subsection adds nothing to the effect of the rules stated in subsection (1), but it has been included since such explicit references were relied upon under the prior acts to preserve the rights of a purchaser by due negotiation unimpaired. The listing is not exhaustive. Only those matters have been repeated in this subsection which were explicitly reserved in the prior acts except in the case of stoppage in transit. Here, the language has been broadened to include "any stoppage" lest an inference be drawn that a stoppage of the goods before or after transit might cut off or otherwise impair the purchaser's rights.

#### Cross references:

Sections 7—103, 7—205, 7—403 and 7—503.

#### Definitional cross references:

"Bailee". Section 7—102.  
 "Delivery". Section 1—201.  
 "Delivery order". Section 7—102.  
 "Document". Section 7—102.  
 "Document of title". Section 1—201.  
 "Duly negotiate". Section 7—501.  
 "Fungible". Section 1—201.  
 "Goods". Section 7—102.  
 "Holder". Section 1—201.  
 "Issuer". Section 7—102.  
 "Person". Section 1—201.  
 "Rights". Section 1—201.  
 "Term". Section 1—201.  
 "Warehouse receipt". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1):* (a) This is new. But see *Ellison v. Hunsinger*, 237 N.C. 619, 75 S.E.2d 884 (1953), which held that where wrongdoer transferred cotton by negotiation of receipts to an innocent purchaser for value without notice, such purchaser obtained absolute title to the cotton.

(b) Similar to meaning of GS 21-32 (1) and 27-45 (1)

(c) This is new. See Official Comment 2.

(d) The first sentence is similar to GS 21-32 (2) and 27-45 (2). The second sentence is new.

*Subsection (2):* See Official Comment 4. The sections in the prior law alluded to in the Official Comment are GS 21-38, 21-39, 21-40, 27-51, 27-52, and 27-53. The prior law referred to "stoppage in transitu" and the UCC refers to "any stoppage."

### § 25-7-503. Document of title to goods defeated in certain cases.—

(1) A document of title confers no right in goods against a person who before issuance of the document had a legal interest or a perfected security interest in them and who neither

(a) delivered or entrusted them or any document of title covering them to the bailor or his nominee with actual or apparent authority to ship, store or sell or with power to obtain delivery under this article (§ 25-7-403) or with power of disposition under this chapter (§§ 25-2-403 and 25-9-307) or other statute or rule of law; nor

(b) acquiesced in the procurement by the bailor or his nominee of any document of title.

(2) Title to goods based upon an unaccepted delivery order is subject to the rights of anyone to whom a negotiable warehouse receipt or bill of lading covering the goods has been duly negotiated. Such a title may be defeated under the next section [§ 25-7-504] to the same extent as the rights of the issuer or a transferee from the issuer.

(3) Title to goods based upon a bill of lading issued to a freight forwarder is subject to the rights of anyone to whom a bill issued by the freight forwarder is duly negotiated; but delivery by the carrier in accordance with part 4 of this article pursuant to its own bill of lading discharges the carrier's obligation to deliver. (1917, c. 37, s. 41; 1919, c. 65, s. 31; C. S., ss. 313, 4081; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 33, Uniform Sales Act; Section 41, Uniform Warehouse Receipts Act; Section 32, Uniform Bills of Lading Act.

**Changes:** Subsection (1) narrows, as compared to the cited sections, the occasions for defeating the document holder's title.

**Purposes of changes:**

1. In general it may be said that the title of a purchaser by due negotiation prevails over almost any interest in the goods which existed prior to the procurement of the document of title if the possession of the goods by the person obtaining the document derived from any action by the prior claimant which introduced the goods into the stream of commerce or carried them along that stream. A thief of the goods cannot indeed by shipping or storing them to his own order acquire power to transfer them to a good faith purchaser. Nor can a tenant or mortgagor defeat any rights of a landlord or mortgagee which have been perfected under the local law merely by wrongfully shipping or storing a portion of the crop or other goods. However, "acquiescence" by the landlord or tenant does not require active consent under subsection (1) (b) and knowledge of the likelihood of storage or shipment with no objection or effort to control it is sufficient to defeat his rights as against one who takes by "due" negotiation of a negotiable document.

On the other hand, where goods are delivered to a factor for sale, even though the factor has made no advances and is limited in his duty to sell for cash, the goods are "entrusted" to him "with actual . . . authority . . . to sell" under subsection (1) (a), and if he procures a negotiable document of title he can transfer the owner's interest to a purchaser by due negotiation. Further, where the factor is in the business of selling, goods entrusted to him simply for safekeeping or storage may be entrusted under circumstances which give him "apparent authority to ship, store or sell" under subsection (1) (a), or power of disposition under Section 2-403, 7-205 or 9-307, or under a statute such as the earlier Factors Acts, or under a rule of law giving effect to apparent ownership. See Section 1-103.

Persons having an interest in goods also frequently deliver or entrust them to agents or servants other than factors for the purpose of shipping or warehousing or under circumstances reasonably contemplating such action. Rounding out the case law development under the prior Acts, this Act is clear that such persons assume full risk that the agent to whom the goods are so delivered may ship or store in breach of duty, take a document to his own order and then proceed to misappropriate it. This Act makes no distinction between possession or mere custody in such situations and finds no exception in the case of larceny by a bailee or the like. The safe-

guard in such situations lies in the requirement that a due negotiation can occur only "in the regular course of business or financing" and that the purchaser be in good faith and without notice. See Section 7-501. Documents of title have no market among the commercially inexperienced and the commercially experienced do not take them without inquiry from persons known to be truck drivers or petty clerks even though such persons purport to be operating in their own names.

Again, where the seller allows a buyer to receive goods under a contract for sale, though as a "conditional delivery" or under "cash sale" terms and on explicit agreement for immediate payment the buyer thereby acquires power to defeat the seller's interest by transfer of the goods to certain good faith purchasers. See Section 2-403. Both in policy and under the language of subsection (1) (a) that same power must be extended to accomplish the same result if the buyer procures a negotiable document of title to the goods and duly negotiates it.

2. Under subsection (1) a delivery order issued by a person having no right in or power over the goods is ineffective unless the owner acts as provided in subsection (1) (a) or (b). Thus the rights of a transferee of a non-negotiable warehouse receipt can be defeated by a delivery order subsequently issued by the transferor only if the transferee "delivers or entrusts" to the "person procuring" the delivery order or "acquiesces" in his procurement. Similarly, a second delivery order issued by the same issuer for the same goods will ordinarily be subject to the first, both under this section and under Section 7-402. After a delivery order is validly issued but before it is accepted, it may nevertheless be defeated under subsection (2) in much the same way that the rights of a transferee may be defeated under Section 7-504. For example, a buyer in ordinary course from the issuer may defeat the rights of the holder of a prior delivery order if the bailee receives notification of the buyer's rights before notification of the holder's rights. Section 7-504(2) (b). But an accepted delivery order has the same effect as a document issued by the bailee.

3. Under subsection (3) a bill of lading issued to a freight forwarder is subordinated to the freight forwarder's certificate, since the bill on its face gives notice of the fact that a freight forwarder is in the picture and has in all probability issued a certificate. But the carrier is protected in following the terms of its own bill of lading.



**Cross references:**

Point 1: Sections 2—403, 7—205, 7—501, 9—307, and 9—309

Point 2: Sections 7—402 and 7—504.

Point 3: Sections 7—402, 7—403 and 7—404.

**Definitional cross references:**

"Bill of lading". Section 1—201.

"Contract for sale". Section 2—106.

"Delivery". Section 1—201.

"Delivery order". Section 7—102.

"Document". Section 7—102.

"Document of title". Section 1—201.

"Duly negotiate". Section 7—501.

"Goods". Section 7—102.

"Person". Section 1—201.

"Right". Section 1—201.

"Warehouse receipt". Section 1—201.

**NORTH CAROLINA COMMENT**

*Subsection (1):* (a) The subsection enlarges the scope of the prior law, according to the Official Comment, Changes. The prior law is, however, substantially the same as the UCC. See GS 21-32 and 27-45.

(b) No cases have been found in North Carolina on this point. However, there

may not be much change in the previous interpretations of the law. See Commercial Nat'l Bank v. Canal-Louisian Bank & Trust Co., 239 U.S. 520, 36 Sup. Ct. 194, 60 L. Ed. 417 (1916).

*Subsection (2):* This subsection is new.

*Subsection (3):* This subsection is new.

**§ 25-7-504. Rights acquired in the absence of due negotiation; effect of diversion; seller's stoppage of delivery.**—(1) A transferee of a document, whether negotiable or nonnegotiable, to whom the document has been delivered but not duly negotiated, acquires the title and rights which his transferor had or had actual authority to convey.

(2) In the case of a nonnegotiable document, until but not after the bailee receives notification of the transfer, the rights of the transferee may be defeated

(a) by those creditors of the transferor who could treat the sale as void under § 25-2-402; or

(b) by a buyer from the transferor in ordinary course of business if the bailee has delivered the goods to the buyer or received notification of his rights; or

(c) as against the bailee by good faith dealings of the bailee with the transferor.

(3) A diversion or other change of shipping instructions by the consignor in a nonnegotiable bill of lading which causes the bailee not to deliver to the consignee defeats the consignee's title to the goods if they have been delivered to a buyer in ordinary course of business and in any event defeats the consignee's rights against the bailee.

(4) Delivery pursuant to a nonnegotiable document may be stopped by a seller under § 25-2-705, and subject to the requirement of due notification there provided. A bailee honoring the seller's instructions is entitled to be indemnified by the seller against any resulting loss or expense. (1917, c. 37, s. 42; 1919, c. 65, s. 32; c. 290; C. S., ss. 314, 4082; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 34, Uniform Sales Act; Sections 41 (b) and 42, Uniform Warehouse Receipts Act; Sections 32(b) and 33, Uniform Bills of Lading Act.

**Changes:** Generally rewritten; Subsection (3) is new.

**Purposes of changes and new matter:**

1. Under the general principles controlling negotiable documents, it is clear that in the absence of due negotiation a transferor cannot convey greater rights than he himself has, even when the negotiation is formally perfect. This section recognizes the transferor's power to transfer rights which he himself has or has "actual authority to convey." Thus, where a negotiable document of title is being transfer-

red the operation of the principle of estoppel is not recognized, as contrasted with situations involving the transfer of the goods themselves. (Compare Section 2—403 on good faith purchase of goods.)

A necessary part of the price for the protection of regular dealings with negotiable documents of title is an insistence that no dealing which is in any way irregular shall be recognized as a good faith purchase of the document or of any rights pertaining to it. So, where the transfer of a negotiable document fails as a negotiation because a requisite indorsement is forged or otherwise missing, the purchaser in good faith and for value may be in the anomalous position of having less rights, in part, than if he had purchased the goods

themselves. True, his rights are not subject to defeat by attachment of the goods or surrender of them to his transferor [Contrast subsection (2)]; but on the other hand, he cannot acquire enforceable rights to control or receive the goods over the bailee's objection merely by giving notice to the bailee. Similarly, a consignee who makes payment to his consignor against a straight bill of lading can thereby acquire the position of a good faith purchaser of goods under provisions of the Article of this Act on Sales (Section 2-403), whereas the same payment made in good faith against an unindorsed order bill would not have such effect. The appropriate remedy of a purchaser in such a situation is to regularize his status by compelling indorsement of the document (see Section 7-506).

2. As in the case of transfer—as opposed to “due negotiation”—of negotiable documents, subsection (1) empowers the transferor of a nonnegotiable document to transfer only such rights as he himself has or has “actual authority” to convey. In contrast to situations involving the goods themselves the operation of estoppel or agency principles is not here recognized to enable the transferor to convey greater rights than he actually has. Subsection (2) makes it clear, however, that the transferee of a nonnegotiable document may acquire rights greater in some respects than those of his transferor by giving notice of the transfer to the bailee.

3. Subsection (3) is in part a reiteration of the carrier's immunity from liability if it honors instructions of the consignor to divert, but there is added a provision protecting the title of the substituted consignee if the latter is a buyer in ordinary course of business. A typical situation would be where a manufacturer, having shipped a lot of standardized goods to A

on nonnegotiable bill of lading, diverts the goods to customer B who pays for them. Under orthodox passage-of-title-by-appropriation doctrine A might reclaim the goods from B. However, no consideration of commercial policy supports this involvement of an innocent third party in the default of the manufacturer on his contract to A; and the common commercial practice of diverting goods in transit suggests a trade understanding in accordance with this subsection.

4. Subsection (4) gives the carrier an express right to indemnity where he honors a seller's request to stop delivery.

5. Section 1-201(27) gives the bailee protection, if due diligence is exercised, similar to that found in the third paragraph of Section 33, Uniform Bills of Lading Act, where the bailee's organization has not had time to act on a notification.

#### Cross references:

Point 1: Sections 2-403 and 7-506.

Point 2: Section 2-403.

Point 3: Sections 7-303 and 7-403(1) (e).

Point 4: Sections 2-705 and 7-403(1) (d).

#### Definitional cross references:

“Bailee”. Section 7-102.

“Bill of lading”. Section 1-201.

“Buyer in ordinary course of business”. Section 1-201.

“Consignee”. Section 7-102.

“Consignor”. Section 7-102.

“Creditor”. Section 1-201.

“Delivery”. Section 1-201.

“Document”. Section 7-102.

“Duly negotiate”. Section 7-501.

“Good faith”. Section 1-201.

“Goods”. Section 7-102.

“Honor”. Section 1-201.

“Notification”. Section 1-201.

“Purchaser”. Section 1-201.

“Rights”. Section 1-201.

### NORTH CAROLINA COMMENT

*Subsection (1):* This subsection is substantially the same as the first sentence in GS 21-33 and the first sentence in GS 27-46.

*Subsection (2):* Similar as to meaning to GS 21-33 and 27-46, but prior to notification of bailee in the case of a nonnegotiable document, the title of transferee might be defeated by attaching creditors. UCC provides for defeat only if creditor may treat the sale as void under GS 25-2-402.

Paragraph (a) and paragraph (c): Similar to GS 21-33 and 27-46.

*Subsection (3):* This subsection seems to be contrary to prior law. See *Hunter v. Randolph*, 128 N.C. 91, 38 S.E. 288 (1901). See also *Peed v. Burleson's Inc.*, 244 N.C. 437, 94 S.E.2d 351 (1956), which discusses the rule and an exception to it.

*Subsection (4):* First sentence is same as prior law. *Farrell v. Richmond & D.R.R.*, 102 N.C. 390, 9 S.E. 302 (1889). The second sentence seems implicit in the decision, but nothing has been found explicitly on the point.

§ 25-7-505. **Indorser not a guarantor for other parties.**—The indorsement of a document of title issued by a bailee does not make the indorser liable for any default by the bailee or by previous indorsers. (1917, c. 37, s. 45; 1919, c. 65, s. 35; C. S., ss. 317, 4085; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 37, Uniform Sales Act; Section 45, Uniform Warehouse Receipts Act; Section 36, Uniform Bills of Lading Act.

**Changes:** No substantial change.

**Purposes of changes:**

The indorsement of a document of title is generally understood to be directed towards perfecting the transferee's rights rather than towards assuming additional obligations. The language of the present section, however, does not preclude the one case in which an indorsement given for value guarantees future action, namely, that in which the bailee has not yet become liable upon the document at the time of the indorsement. Under such circum-

stances the indorser, of course, engages that appropriate honor of the document by the bailee will occur. See Section 7—502(1) (d) as to negotiable delivery orders. However, even in such a case, once the bailee attorns to the transferee, the indorser's obligation has been fulfilled and the policy of this section excludes any continuing obligation on the part of the indorser for the bailee's ultimate actual performance.

**Cross reference:**

Section 7—502.

**Definitional cross references:**

"Bailee". Section 7—102.

"Document of title". Section 1—201.

"Party". Section 1—201.

#### NORTH CAROLINA COMMENT

Similar to GS 21-36 and 27-49.

§ 25-7-506. **Delivery without indorsement; right to compel indorsement.**—The transferee of a negotiable document of title has a specifically enforceable right to have his transferor supply any necessary indorsement but the transfer becomes a negotiation only as of the time the indorsement is supplied. (1917, c. 37, s. 43; 1919, c. 65, s. 33; C. S., ss. 315, 4083; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 35, Uniform Sales Act; Section 43, Uniform Warehouse Receipts Act; Section 34, Uniform Bills of Lading Act.

**Changes:** Consolidated and rewritten; former requirement that transfer be "for value" eliminated.

**Purposes of changes:**

1. From a commercial point of view the intention to transfer a negotiable document of title which requires an indorsement for its transfer, is incompatible with an intention to withhold such indorsement and so defeat the effective use of the document. This position is sustained by the absence of any reported case applying the prior provisions in almost forty years of decisions. Further, the preceding section and the Comment thereto make it clear that an indorsement generally imposes no responsibility on the indorser.

2. Although this section provides that

delivery of a document of title without the necessary indorsement is effective as a transfer, the transferee, of course, has not regularized his position until such indorsement is supplied. Until this is done he cannot claim rights under due negotiation within the requirements of this Article (subsection (4) of Section 7—501) on "due negotiation." Similarly, despite the transfer to him of his transferor's title, he cannot demand the goods from the bailee until the negotiation has been completed and the document is in proper form for surrender. See Section 7—403(2).

**Cross references:**

Point 1: Section 7—505.

Point 2: Sections 7—501(4) and 7—403(2).

**Definitional cross references:**

"Document of title". Section 1—201

"Rights". Section 1—201.

#### NORTH CAROLINA COMMENT

Similar to GS 21-34 and 27-47.

§ 25-7-507. **Warranties on negotiation or transfer of receipt or bill.**—Where a person negotiates or transfers a document of title for value otherwise than as a mere intermediary under the next following section [§ 25-7-508], then



unless otherwise agreed he warrants to his immediate purchaser only in addition to any warranty made in selling the goods

(a) that the document is genuine; and

(b) that he has no knowledge of any fact which would impair its validity or worth; and

(c) that his negotiation or transfer is rightful and fully effective with respect to the title to the document and the goods it represents. (1917, c. 37, s. 44; 1919, c. 65, s. 34; C. S., ss. 316, 4084; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 36, Uniform Sales Act; Section 44, Uniform Warehouse Receipts Act; Section 35, Uniform Bills of Lading Act.

**Changes:** Consolidated and rewritten without change in policy.

##### Purposes of changes:

1. This section omits provisions of the prior acts on warranties as to the goods as unnecessary and incomplete. It is unnecessary because such warranties derive from the contract of sale and not from the transfer of the documents. The fact that transfer of control occurs by way of a document of title does not limit or displace the ordinary obligations of a seller. The former provision, moreover, was incomplete because it did not expressly include all of the warranties which might rest upon a seller under such circumstances. This Act handles the problem by means of the precautionary reference to

any warranty made in selling the goods." If the transfer of documents attends or follows the making of a contract for the sale of goods, the general obligations on warranties as to the goods (Sections 2—312 through 2—318) are brought to bear as well as the special warranties under this section.

2. The limited warranties of a delivering or collecting intermediary are stated in Section 7—508.

##### Cross references:

Point 1: Sections 2—312 through 2—318.

Point 2: Section 7—508.

##### Definitional cross references:

"Document". Section 7—102.

"Document of title". Section 1—201.

"Genuine". Section 1—201.

"Goods". Section 7—102.

"Purchaser". Section 1—201.

"Person". Section 1—201.

"Value". Section 1—201.

#### NORTH CAROLINA COMMENT

Similar to GS 21-35 and 27-48. For change as to warranties, see Official Comment 1.

§ 25-7-508. **Warranties of collecting bank as to documents.**—A collecting bank or other intermediary known to be entrusted with documents on behalf of another or with collection of a draft or other claim against delivery of documents warrants by such delivery of the documents only its own good faith and authority. This rule applies even though the intermediary has purchased or made advances against the claim or draft to be collected. (1917, c. 37, s. 46; 1919, c. 65, s. 36; C. S., ss. 318, 4086; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

##### Purposes:

1. To state the limited warranties given with respect to the documents accompanying a documentary draft.

2. In warranting its authority a bank only warrants its authority from its transferor. See Section 4—203. It does not warrant the genuineness or effectiveness of the document. Compare Section 7—507.

3. Other duties and rights of banks

handling documentary drafts for collection are stated in Article 4, Part 5.

##### Cross references:

Sections 4—203 and 7—507, 4—501 through 4—504.

##### Definitional cross references:

"Collecting bank". Section 4—105.

"Delivery". Section 1—201.

"Document". Section 7—102.

"Draft". Section 5—103.

"Good faith". Section 1—201.

## NORTH CAROLINA COMMENT

Similar to GS 21-37 and 27-50 and to *Mason v. A. E. Nelson Cotton Co.*, 148 N.C. 492, 62 S.E. 625 (1908), which gives a full and careful discussion of the problem.

Notice that the UCC applies explicitly to a mere holder for collection; the prior statutes applied to a "mortgagee or pledgee or other holder of a bill for security."

§ 25-7-509. **Receipt or bill; when adequate compliance with commercial contract.**—The question whether a document is adequate to fulfill the obligations of a contract for sale or the conditions of a credit is governed by the articles on sales (article 2) and on letters of credit (article 5). (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Cross references:**

Articles 2 and 5.

**Purposes:**

**Definitional cross references:**

"Contract for sale". Section 2—106.

"Document". Section 7—102.

To cross-refer to the Articles of this Act which deal with the substantive issues of the type of document of title required under the contract entered into by the parties.

## PART 6.

## WAREHOUSE RECEIPTS AND BILLS OF LADING: MISCELLANEOUS PROVISIONS.

§ 25-7-601. **Lost and missing documents.**—(1) If a document has been lost, stolen or destroyed, a court may order delivery of the goods or issuance of a substitute document and the bailee may without liability to any person comply with such order. If the document was negotiable the claimant must post security approved by the court to indemnify any person who may suffer loss as a result of non-surrender of the document. If the document was not negotiable, such security may be required at the discretion of the court. The court may also in its discretion order payment of the bailee's reasonable costs and counsel fees.

(2) A bailee who without court order delivers goods to a person claiming under a missing negotiable document is liable to any person injured thereby, and if the delivery is not in good faith becomes liable for conversion. Delivery in good faith is not conversion if made in accordance with a filed classification or tariff or, where no classification or tariff is filed, if the claimant posts security with the bailee in an amount at least double the value of the goods at the time of posting to indemnify any person injured by the delivery who files a notice of claim within one year after the delivery. (1917, c. 37, ss. 11, 14; 1919, c. 65, ss. 11, 14; C. S., ss. 293, 296, 4051, 4054; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 14, Uniform Warehouse Receipts Act; Section 17, Uniform Bills of Lading Act.

**Changes:** General Revision, Principal innovations include: affirmation of bailee's privilege to deliver to claimant without resort to judicial proceedings if the bailee acts in good faith and is willing to take the full risk of loss in case the lost document turns up in the hands of an innocent purchaser; explicit authorization to the court to order bailee to issue a substitute document rather than make physical delivery of the goods; inclusion of "stolen" as well as lost documents; extension of section to non-negotiable documents.

**Purposes of changes:** The purposes of

the changes insofar as they are not self-evident are as follows:

1. As to bailee's privilege to deliver without court order. Doubt had arisen as to the propriety of such action under Section 54 of the Uniform Warehouse Receipts Act, which made it a crime to deliver goods covered by negotiable receipts without taking up the receipts "except in the cases provided for in Section 14" (the lost receipts section). This has been interpreted by one court as exempting from criminal liability only if the judicial procedure of Section 14 was followed. *Dahl v. Winter-Truesdell-Diercks Co.*, 61 N.D. 84, 237 N.W. 202 (1931). Although the criminal provisions are not being re-

enacted in this Act (and the Uniform Bills of Lading Act never did include such a criminal provision), it seems advisable to clarify the legality of the well established commercial practice of bailees to make delivery where they are satisfied that the claimant is the person entitled under a lost document. Since the bailee remains liable on the document in such cases, he will usually insist that the claimant provide an indemnity bond.

2. The old acts provide only for compulsory delivery of goods; this section provides also for compulsory issuance of a substitute document. If continuance of the bailment is desirable there is no reason to require the goods to be withdrawn and re-deposited in order to secure a negotiable document. The present acts would probably be so interpreted. Section 20 of the Federal Warehouse Act and some state laws expressly require issuance of a new receipt on proof of loss and posting of bond.

3. Claimants on non-negotiable instruments are permitted to avail themselves of this procedure because straight bills of lading sometimes contain provisions that the goods shall not be delivered except upon production of the bill. If the carrier should choose to insist upon production of the bill, the consignee should have some means of compelling delivery on satisfactory proof of entitlement.

Ordinarily no security would be necessary to indemnify a bailee in delivering to the person named in a non-negotiable document. But disputes as to negotiability may arise, in which case if there is a rea-

sonable doubt on the point the bailee should be protected against the possibility that the missing document would, in the hands of an innocent purchaser for value, be held negotiable.

4. It seems unnecessary to state, as do the present acts, that the court shall act "on satisfactory proof of such loss or destruction." The right of action created by the section is conditioned on a document being lost, stolen or destroyed. Plaintiff must of course bring himself within the section. There is nothing in the language of the old acts to suggest that they intended to impose anything but the normal burden of proof on the plaintiff in such proceedings.

5. Subsection (2) makes it clear that after delivery without court order the bailee remains liable for actual damages. Liability for conversion is provided where the delivery is dishonest, but excluded where a filed classification or tariff is followed in good faith, or where the described bond is posted in good faith and no classification or tariff is filed. Liability for conversion in other cases is left to judicial decision.

#### Definitional cross references:

"Bailee". Section 7—102.

"Bill of lading". Section 1—201.

"Delivery". Section 1—201.

"Document". Section 7—102.

"Good faith". Section 1—201.

"Goods". Section 7—102.

"Person". Section 1—201.

"Warehouse receipt". Section 1—201.

"Warehouseman". Section 7—102.

### NORTH CAROLINA COMMENT

*Subsection (1):* Generally in accord: GS 21-15 and 27-18. Prior law applied explicitly to negotiable instruments. Non-negotiable instruments were not mentioned.

*Subsection (2):* Generally in accord: GS 21-12 and 27-15, but the last part of the first sentence changes the prior law, for

delivery to the wrong person, good faith or not, was conversion. See implications of holding in *Killingsworth v. Norfolk So. R.R.*, 171 N.C. 47, 87 S.E. 947 (1916), and *Griggs v. Stoker Serv. Co.*, 229 N.C. 572, 50 S.E.2d 914 (1948).

#### § 25-7-602. Attachment of goods covered by a negotiable document.

—Except where the document was originally issued upon delivery of the goods by a person who had no power to dispose of them, no lien attaches by virtue of any judicial process to goods in the possession of a bailee for which a negotiable document of title is outstanding unless the document be first surrendered to the bailee or its negotiation enjoined, and the bailee shall not be compelled to deliver the goods pursuant to process until the document is surrendered to him or impounded by the court. One who purchases the document for value without notice of the process or injunction takes free of the lien imposed by judicial process. (1917, c. 37, s. 25; 1919, c. 65, s. 23; C. S., ss. 305, 4065; 1965, c. 700, s. 1.)

**Order Constituting Injunction.**—In view to prevent the holder of warehouse certificates from disposing of them except un-



der order of the court, was a sufficient compliance with the Uniform Warehouse Receipts Act, constituting it an injunc-

tion. *Standard Bonded Warehouse Co. v. Cooper*, 30 F.2d 842 (4th Cir. 1929).

#### OFFICIAL COMMENT

**Prior uniform statutory provisions:** Section 25, Uniform Warehouse Receipts Act; Section 24, Uniform Bills of Lading Act.

**Changes:** Consolidated and rewritten.

**Purposes of changes:**

1. The purpose of the section is to protect the bailee from conflicting claims of the document holder and the judgment creditors of the person who deposited the goods. The rights of the former prevail unless, in effect, the judgment creditors immobilize the negotiable document. However, if the document was issued upon deposit of the goods by a person who had no power to dispose of the goods so that the document is ineffective to pass title, judgment liens are valid to the extent of the debtor's interest in the goods.

2. The last sentence covers the possibility that the holder of a document who has been enjoined from negotiating it will violate the injunction by negotiating to an innocent purchaser for value. In such case the lien will be defeated.

**Cross reference:**

Point 1: Section 7—503.

**Definitional cross references:**

"Bailee". Section 7—102.

"Delivery". Section 1—201.

"Document". Section 7—102.

"Goods". Section 7—102.

"Notice". Section 1—201.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Value". Section 1—201.

#### NORTH CAROLINA COMMENT

Generally in accord: GS 21-24 and 27-29.

§ 25-7-603. **Conflicting claims; interpleader.**—If more than one person claims title or possession of the goods, the bailee is excused from delivery until he has had a reasonable time to ascertain the validity of the adverse claims or to bring an action to compel all claimants to interplead and may compel such interpleader, either in defending an action for non-delivery of the goods, or by original action, whichever is appropriate. (1917, c. 37, ss. 17, 18; 1919, c. 65, ss. 17, 18; C. S., ss. 299, 300, 4057, 4058; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 16 and 17, Uniform Warehouse Receipts Act; Sections 20 and 21, Uniform Bills of Lading Act.

**Changes:** Consolidation without substantial change.

**Purposes of changes:**

The section enables a bailee faced with conflicting claims to the goods to compel

the claimants to litigate their claims with each other rather than with him.

**Definitional cross references:**

"Action". Section 1—201.

"Bailee". Section 7—102.

"Delivery". Section 1—201.

"Goods". Section 7—102.

"Person". Section 1—201.

"Reasonable time". Section 1—204.

#### NORTH CAROLINA COMMENT

This subsection is substantially a rephrasing of GS 21-18 and 21-19 and GS 27-21 and 27-22. However, the prior law

was confined to common carriers, GS 21-4, and warehousemen, GS 27-5, whereas the UCC applies to "the bailee."

### ARTICLE 8.

#### *Investment Securities.*

#### NORTH CAROLINA COMMENT

Article 8 of the UCC is essentially a negotiable instruments law geared to the special needs and characteristics of investment securities. Thus, the Code departs from statutes such as the NIL, which embraced without distinction both short-term commercial paper and bonds and other long-term creditor paper. Article 8's premise is that all types of investment securities, whether bonds or stocks, are sufficiently similar that they can all be governed by the same uniform statute. Article 8's basic object is to give

investment securities full and complete negotiability, with the major incidents normally associated with that concept: Ready transfer by delivery or indorsement and destruction of issuer defenses to and equities of ownership in investment securities held by bona fide purchasers. Article 8 does not, of course, deal with all aspects of investment securities, e.g., those matters covered by the corporation and "blue sky" laws or by governmental bond statutes, but it states rules governing the transfer of investment paper both on initial issue and on subsequent transfer among owners of the paper.

The coverage of article 8 rests upon the broad definition of the term "security" which includes all types of investment securities currently marketed today. It includes creditor securities such as bonds and debentures, equity securities such as shares of stock, warrants and rights and special types of stock, and other securities such as voting trust certificates, equipment trust certificates, mutual fund shares, and the like. The definition of "security" carries forward the process, evident in both the NIL and the Uniform Stock Transfer Act, of reducing the creditor or equity interest to the instrument itself, so that transfer of the instrument is an effective and complete transfer of the interest.

Article 8 states the rights of the initial purchaser of a security from an issuer such as a corporation or a governmental unit. In general, both the first and subsequent purchasers will cut off defenses if they paid value and took without notice. This includes, for example, a defense based on the act of a faithless employee issuing stock to himself and selling it or using it as collateral for a loan. Defenses of governmental units are subject to special rules designed to protect the public interest as well as the reasonable expectations of the purchaser.

Article 8 gives to bona fide purchasers at least as great a degree of freedom from unknown equities of ownership as the NIL gave to holders in due course. Indeed, unlike the older law, the Code permits one who purchases an overdue security within specified time limits to become a bona fide purchaser and cut off issuer defenses and ownership equities, thereby taking account of frequent trading in overdue or defaulted securities. The Code states in detail the procedures for transfer of investment securities, the warranties of transferors, and, of special importance, the warranties of persons giving the customary guarantee of the transferor's signature.

Article 8 states the rights, duties, and liabilities of the issuer when the transferee of a security presents it to the issuer (or his transfer agent) and request registration of transfer into his own name on the issuer's books. In this situation the Code gives the issuer broad relief from possible liabilities. In general, the issuer is not liable for registering a wrongful transfer of a security such as a transfer in breach of trust, but remains absolutely liable for registering transfer on an unauthorized or forged indorsement, although in this situation the issuer may fully rely on the warranty of the signature guarantor. In this area, the Code follows the lead given by two other North Carolina statutes: The Uniform Fiduciaries Act and the Uniform Act for Simplification of Fiduciary Security Transfers. Like the latter statute, the Code indicates what documents the issuer need obtain when he registers transfer of a security, and states the issuer's limited duty of inquiry.

Article 8 provides businessmen, lawyers and judges with the clearest and most comprehensive statement of the important legal rules governing investment securities. It is also a logical outcome of the developments taking place in the law and in the practices of the investment community, both locally and nationally.

## PART 1.

### SHORT TITLE AND GENERAL MATTERS.

§ 25-8-101. **Short title.**—This article shall be known and may be cited as Uniform Commercial Code—Investment Securities. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

The Article is neither a Blue Sky Law nor a corporation code. It may be likened rather to a negotiable instruments law dealing with securities. The instruments covered are those included in the definition of "security" in Section 8—102.

Thus the Article deals with bearer bonds, formerly covered by the Uniform

Negotiable Instruments Law, and with registered bonds, not previously covered by any Uniform Law. It also covers certificates of stock, formerly provided for by the Uniform Stock Transfer Act and additional types of investment paper not now covered by any Uniform Act.

**NORTH CAROLINA COMMENT**

This article is a negotiable instruments law for all forms of investment securities as distinguished from commercial paper (article 3) and documents of title (article 7). Article 8 replaces the NIL, adopted in North Carolina in 1899, so far as that statute covered bonds and debentures. This article also replaces the Uniform Stock

Transfer Act, adopted in 1941 and reenacted in 1955 as part of the Business Corporation Act. Article 8 does not replace the Uniform Fiduciaries Act (GS 32-1 through 32-13, adopted in 1923), nor the Uniform Act for Simplification of Fiduciary Security Transfers (GS 32-14 through 32-24, adopted in 1959).

**§ 25-8-102. Definitions and index of definitions.**—(1) In this article unless the context otherwise requires

(a) A “security” is an instrument which  
(i) is issued in bearer or registered form; and  
(ii) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and

(iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

(b) A writing which is a security is governed by this article and not by Uniform Commercial Code—Commercial Paper even though it also meets the requirements of that article. This article does not apply to money.

(c) A security is in “registered form” when it specifies a person entitled to the security or to the rights it evidences and when its transfer may be registered upon books maintained for that purpose by or on behalf of an issuer or the security so states.

(d) A security is in “bearer form” when it runs to bearer according to its terms and not by reason of any indorsement.

(2) A “subsequent purchaser” is a person who takes other than by original issue.

(3) A “clearing corporation” is a corporation all of the capital stock of which is held by or for a national securities exchange or association registered under a statute of the United States such as the Securities Exchange Act of 1934.

(4) A “custodian bank” is any bank or trust company which is supervised and examined by State or federal authority having supervision over banks and which is acting as custodian for a clearing corporation.

(5) Other definitions applying to this article or to specified parts thereof and the sections in which they appear are:

“Adverse claim.” § 25-8-301.

“Bona fide purchaser.” § 25-8-302.

“Broker.” § 25-8-303.

“Guarantee of the signature.” § 25-8-402.

“Intermediary bank.” § 25-4-105.

“Issuer.” § 25-8-201.

“Overissue.” § 25-8-104.

(6) In addition article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:**  
None.

**Purposes:**

To define the basic term of this Article, “security” and so to identify the instruments to which this Article applies. Notice that if an instrument is a “security” as here defined it is governed by this Arti-

cle and not by Article 3. See also Section 3—103(1). Money (Section 1—201) is not a security. Nor is it commercial paper (Section 3—103).

This section also defines certain other terms, and lists other sections containing other definitions.

The definition of “security” is functional



rather than formal, and it is believed will cover anything which securities markets, including not only the organized exchanges but as well the "over-the-counter" markets, are likely to regard as suitable for trading. For example, transferable warrants evidencing rights to subscribe for shares in a corporation will normally be "securities" within the definition, since they (a) are issued in bearer or registered form, (b) are of a type commonly dealt in on securities markets, (c) constitute a class or series of instruments, and (d) evidence an obligation of the issuer, namely the obligation to honor the warrant upon its due exercise and issue shares accordingly.

On the other hand the definition does

not cover anything (whether it is a "security" or not under regulatory statutes like the Securities Act of 1933 or a state Blue Sky Law) which is not either "of a type commonly dealt in upon securities exchanges or markets" or "commonly recognized . . . as a medium for investment."

**Cross reference:**

Section 3—103.

**Definitional cross references:**

"Bearer". Section 1—201.

"Issuer". Section 8—201.

"Money". Section 1—201.

"Person". Section 1—201.

"Rights". Section 1—201.

"Term". Section 1—201.

"Writing". Section 1—201.

### NORTH CAROLINA COMMENT

The definition of "security" in GS 25-8-102 (1) (a), and the ancillary definitions of "registered form" and "bearer form" securities, determine the coverage of article 8, which applies to every type of investment security currently traded in the existing securities markets. All such securities are negotiable instruments under GS 25-8-105 (1). Securities in registered form have been explicitly recognized as negotiable instruments both under case law, *Thomas v. De Moss*, 202 N.C. 646, 163 S.E. 759 (1932), and under statutes, including the Uniform Act for Simplification of Fiduciary Security Transfers, GS 32-14 (6), and governmental bond statutes, e.g., GS 136-89.66 (turnpike revenue bonds). Bonds in bearer form were also negotiable

instruments under prior law. *Bankers Trust Co. v. City of Statesville*, 203 N.C. 399, 166 S.E. 169 (1932). The definition likewise covers governmental bonds made payable to bearer but giving the holder a privilege of registering principal or principal and interest, GS 142-1, 142-5, and 142-6 (State bonds); GS 153-106 (County Finance Act).

Since the definition of "security" applies only to article 8 of the Code, it does not limit the broader definition of the term "security" in police statutes such as the North Carolina Securities Law, GS 78-2 (g), or in special statutes such as the Uniform Gifts to Minors Act, GS 33-68 (1).

The other definitions in GS 25-8-102 do not conflict with prior North Carolina law and practice.

§ 25-8-103. **Issuer's lien.**—A lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right of the issuer to such lien is noted conspicuously on the security. (1941, c. 353, s. 15; G. S., s. 55-95; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Uniform Stock Transfer Act, Section 15.

**Purposes:**

The rule of Section 15 of the former Act is made applicable to all "securities" covered by the Article. A corresponding rule as to restrictions on transfer imposed by the issuer appears at Section 8—204.

"Noted" makes clear that the text of the

lien provision need not be set forth in full. However, this would not override a provision of an applicable corporation code requiring statement *in haec verba*.

**Cross reference:**

Section 8—204.

**Definitional cross references:**

"Conspicuous". Section 1—201.

"Issuer". Section 8—201.

"Security". Section 8—102.

### NORTH CAROLINA COMMENT

This section extends to all investment securities the requirement of the Uniform Stock Transfer Act that an issuer's lien must be indicated on the stock certificate.

The lien need not be stated in full but need only be "conspicuously noted" on the instrument.

§ 25-8-104. **Effect of overissue; "overissue."**—(1) The provisions of this article which validate a security or compel its issue or reissue do not apply to the extent that validation, issue or reissue would result in overissue; but

(a) if an identical security which does not constitute an overissue is reasonably available for purchase, the person entitled to issue or validation may compel the issuer to purchase and deliver such a security to him against surrender of the security, if any, which he holds; or

(b) if a security is not so available for purchase, the person entitled to issue or validation may recover from the issuer the price he or the last purchaser for value paid for it with interest from the date of his demand.

(2) "Overissue" means the issue of securities in excess of the amount which the issuer has corporate power to issue. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:**  
None.

##### Purposes:

1. Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Corporation codes universally require that the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Historically, special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See, for example, *McWilliams v. Geddes & Moss Undertaking Co.* 169 So. 894 (1936 La.); *Crawford v. Twin City Oil Co.* 216 Ala. 216. 113 So. 61 (1927); *New York and New Haven R. R. Co. v. Schuyler*, 34 N.Y. 30 (1865). This conception persists despite modern corporation codes under which, by action of directors and stockholders, additional shares can be authorized by charter amendment and thereafter issued. This section does not give a person entitled to validation, issue or reissue of a security, the right to compel amendment of the charter to authorize additional shares. Therefore, in a case where issue of an additional security would require charter amendment, the plaintiff is limited to the two alternate remedies set forth in paragraphs (a) and (b) of subsection (1).

2. Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more holders may be willing to sell at a not unreasonable price, the issuer, although unable to issue ad-

ditional shares, will be able to purchase them and may be compelled to follow that procedure. *West v. Tintic Standard Mining Co.* 71 Utah 158, 263 P. 490, 56 A.L.R. 1190 (1928).

3. The right to recover damages from an issuer who has permitted an overissue to occur is well settled. *New York v. Schuyler*, 34 N.Y. 30 (1865). The measure of such damages, however, has been open to question, some courts basing them upon the value of the stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. *Allen v. South Boston R. Co.*, 150 Mass. 200, 22 N.E. 917, 5 L.R.A. 716, 15 Am.St.Rep. 185 (1889); *Commercial Bank v. Kortright*, 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last holder who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

4. This section modifies and controls the rules otherwise laid down in this Article as to the validation and issue of securities. The particular sections so modified are listed in the cross-references.

##### Cross references:

Point 4: See Sections 8—202, 8—205, 8—206, 8—208, 8—311 and Part 4 of this Article.

##### Definitional cross references:

"Issuer". Section 8—201.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Purchaser". Section 1—201.

"Security". Section 8—102.

"Value". Section 1—201.

#### NORTH CAROLINA COMMENT

Since an overissue of shares is void, 43 S.E. 639 (1903), recognized that a bona fide purchaser who would otherwise be

entitled to a stock certificate could recover the value of the shares if issue of a certificate would result in an overissue. Since GS 25-8-104 authorizes an action for the value of the shares only if the issuer

is unable to purchase and deliver an identical security not constituting an overissue, it gives an additional remedy and also limits the scope of the prior case-law remedy.

**§ 25-8-105. Securities negotiable; presumptions.**—(1) Securities governed by this article are negotiable instruments.

(2) In any action on a security

(a) unless specifically denied in the pleadings, each signature on the security or in a necessary indorsement is admitted;

(b) when the effectiveness of a signature is put in issue the burden of establishing it is on the party claiming under the signature but the signature is presumed to be genuine or authorized;

(c) when signatures are admitted or established production of the instrument entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security; and

(d) after it is shown that a defense or defect exists the plaintiff has the burden of establishing that he or some person under whom he claims is a person against whom the defense or defect is ineffective (§ 25-8-202). (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provisions:**  
None.

**Purposes:**

1. This Article gives to bona fide purchasers of securities rights greater than those they would have if the things bought were chattels or simple contracts. See e. g. Sections 8—202, 8—301. Subsection (1) of this section states the conclusion: Securities are negotiable instruments. It remains true that the particular kinds of negotiable instruments defined in this Article as “securities” are governed by this Article and not by Article 3. See Sections 8—102(1) (b) and 3—103(1). But by subsection (2) of this section the particular

rules stated in Section 3—307 for the negotiable instruments governed by Article 3 are adapted to securities.

2. “Any action on a security” includes any action or proceeding brought against the issuer to enforce a right or interest represented by the security, e.g., to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization.

**Cross reference:**

Sections 3—103, 3—307, 8—202, 8—301.

**Definitional cross reference:**

“Security”. Section 8—102.

#### NORTH CAROLINA COMMENT

GS 25-8-105 (1)'s explicit statement of the negotiability of investment securities accords with North Carolina case holdings. Banker's Trust Co. v. City of Statesville, 203 N.C. 399, 166 S.E. 169 (1932) (coupon bonds); Thomas v. De Moss, 202 N.C. 646, 163 S.E. 759 (1932) (registered bonds). North Carolina governmental bond statutes often declare that such bonds are negotiable, e.g., GS 160-485 (bonds of parking authorities), even if they would

have been nonnegotiable under the NIL, e.g., GS 136-89.41 (bridge revenue bonds); GS 160-417 (Revenue Bond Act of 1938). Although not technically negotiable instruments, shares of stock have long enjoyed virtually all attributes of negotiability, both before the Uniform Stock Transfer Act, see *Castellote v. Jenkins*, 186 N.C. 166, 119 S.E. 202 (1923), and under that statute, see especially GS 55-80, 55-95.

**§ 25-8-106. Applicability.**—The validity of a security and the rights and duties of the issuer with respect to registration of transfer are governed by the law (including the conflict of laws rules) of the jurisdiction of organization of the issuer. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:**  
None.

**Purpose:**

To state, in accordance with the pre-

vailing case law, a specific conflicts rule applicable in the securities field. Other conflicts rules applicable generally and under this Article are stated in Section 1—105.



**Cross references:**

Sections 1—105 and 8—202 and Part 4 of this Article.

**Definitional cross reference:**

"Issuer". Section 8—201.

**NORTH CAROLINA COMMENT**

Although the Code's general choice-of-law rule (GS 25-1-105) permits the parties, by contract, to agree to be governed by the law of any state which has a "reasonable relation" to the transaction, GS 25-8-106 states an exception, not subject to contract variation, that the law of the jurisdiction of an issuer's organization governs the validity of its securities and its rights and duties as to registering transfer of those securities. Hence, North Carolina

law applies to securities of North Carolina corporations, but North Carolina courts would apply the law of other states with respect to securities of out-of-State issuers. This accords with prior law. In *Suskin v. Hodges*, 216 N.C. 333, 4 S.E.2d 891 (1939), an action involving stock issued by a Maryland corporation, the court applied the Uniform Stock Transfer Act which at the time had been adopted in Maryland but not in North Carolina.

**§ 25-8-107. Securities deliverable; action for price.** — (1) Unless otherwise agreed and subject to any applicable law or regulation respecting short sales, a person obligated to deliver securities may deliver any security of the specified issue in bearer form or registered in the name of the transferee or indorsed to him or in blank.

(2) When the buyer fails to pay the price as it comes due under a contract of sale the seller may recover the price

(a) of securities accepted by the buyer; and

(b) of other securities if efforts at their resale would be unduly burdensome or if there is no readily available market for their resale. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purpose:**

1. The rights and interests represented by securities of the same issue are "fungible". Section 1—201(17). To the extent that instruments representing such rights and interests (securities) are available in form to be further transferred by the person to whom they are deliverable, the securities themselves are fungible. Subsection (1) states the generally accepted legal consequences of such fungibility. "Unless otherwise agreed", the seller, bailee, broker or other "person obligated to deliver securities" need not deliver any specific instrument, but may select (e. g., from "a fungible bulk" (Section 8—313(2))) any security of the proper issue, in bearer form or appropriately registered or indorsed.

Rules of the organized markets limiting the forms of registration in which securities are deliverable in transactions on such markets are matters "otherwise agreed". Cases such as *Parsons v. Martin*, 77 Mass. (11 Gray) 111 (1858) and *Rumery v. Brooks*, 205 App.Div. 283, 199 N.Y.Supp. 517 (1st Dept. 1923) holding a broker liable for conversion if he registers transfer of a customer's securities held in "cash account" out of the customer's name or tenders on demand for delivery a different

though equivalent security are rejected. However, this Act does not enlarge the rights of a broker as to such securities so as to permit him without the customer's consent to pledge them for his own indebtedness as he may properly do with securities held in a "margin account" and upon which he has acquired a lien for advances. The distinction is carefully preserved in Statute (e. g., N.Y. Penal Law § 956) and case law. In *re Mills*, 125 App. Div. 730, 110 N.Y.Supp. 314 (1st Dept. 1908).

2. Subsection (2) is designed to follow the dictum in *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934) in this context. Paragraph (b) is applicable where for example (i) the securities are those of a "closely-held" corporation not dealt in on any organized market; or (ii) because of the necessity for compliance with the registration requirements of the Securities Act of 1933 or other regulatory provisions or procedures prior to offering the particular securities on the market substantial delay and expense would be involved. The approval of these particular remedies does not constitute disapproval of other remedies that may exist under other rules of law. Section 1—103.

**Cross references:** Sections 1—103; 2—708; 2—709; 8—313(2).

**Definitional cross references:**

"Action". Section 1—201(1).

"Contract". Section 1—201(11).

"Person". Section 1—201(30).

"Security". Section 8—102.

**NORTH CAROLINA COMMENT**

Subsection (1), by making securities fungible for purposes of performing contracts to deliver securities, accords with accepted practices of securities brokers and does not appear to be inconsistent with prior North Carolina law. Subsection (2) allows an action for the price of securities if the buyer has accepted them, or if, despite nonacceptance, re-sale would be difficult (e.g., the securities would have to be registered for sale) or no ready market is available (e.g., in the case of shares of stock in a closely held corporation). GS

25-8-107 does not cover a seller's remedy if the buyer has not accepted the securities, or a buyer's remedy for breach of a contract to sell stock or other securities. In situations not covered by GS 25-8-107, the Official Comment to GS 25-2-105 indicates that remedies analogous to those under article 2 (sales) are available under article 8 if a rule of sales law is "sensible" in this context and is not preempted by a specific rule under article 8, such as GS 25-8-107 (2).

**PART 2.****ISSUE—ISSUER.**

§ 25-8-201. "Issuer."—(1) With respect to obligations on or defenses to a security "issuer" includes a person who

(a) places or authorizes the placing of his name on a security (otherwise than as authenticating trustee, registrar, transfer agent or the like) to evidence that it represents a share, participation or other interest in his property or in an enterprise or to evidence his duty to perform an obligation evidenced by the security; or

(b) directly or indirectly creates fractional interests in his rights or property which fractional interests are evidenced by securities; or

(c) becomes responsible for or in place of any other person described as an issuer in this section.

(2) With respect to obligations on or defenses to a security a guarantor is an issuer to the extent of his guaranty whether or not his obligation is noted on the security.

(3) With respect to registration of transfer (part 4 of this article) "issuer" means a person on whose behalf transfer books are maintained. (1899, c. 733, ss. 29, 60 to 62; Rev., ss. 2177, 2209 to 2211; C. S., ss. 3009, 3041 to 3043; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 29, 60, 61 and 62, Uniform Negotiable Instruments Law.

**Changes:** Definition of person liable on instrument adapted to investment securities.

**Purposes of changes:**

1. This Article includes many types of securities not covered by the Uniform Negotiable Instruments Law (Section 8—102). The term "issuer" is here defined as a word of art, applicable to the various kinds of securities covered.

2. This definition is for purposes of this Article only and has no implications with respect to other statutes using the same term in a different sense. Thus as defined in the Securities Exchange Act of 1934, the term issuer expressly excludes trustees under equipment-trust certificates. In those

common forms of equipment trust certificates where the payments of principal and interest are the direct obligation of the indenture trustee, such trustee is an "issuer" within subparagraph (a) of this section.

Subsection (2) distinguishes the obligations of a guarantor as issuer from those of the principal obligor. However, it does not exempt the guarantor from the impact of subsection (4) of Section 8—202. Whether or not the obligation of the guarantor is noted on the security is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security was originally issued the guaranty would probably have been noted on the security. However, if the relationship arose afterward, e.g., through a purchase of

stock or properties, or through merger or consolidation, probably the notation would not have been made. Nonetheless, the holder of the security is entitled to the benefit of the obligation of the guarantor.

3. Subsection (3) narrows the definition of "issuer" for purposes of Part 4 of this Article (registration of transfer). It is supplemented by Section 8—406.

#### Cross references:

Point 1: Section 8—102.

Point 2: Section 8—202.

Point 3: Part 4 of this Article.

#### Definitional cross references:

"Person". Section 1—201.

"Rights". Section 1—201.

"Security". Section 8—102.

### NORTH CAROLINA COMMENT

The term "issuer," as defined in this section, conforms to prior law. It closely accords with the definition of the same term in the Uniform Gifts to Minors Act, GS 33-68 (h). Since GS 25-8-201's definition

applies only to article 8 of the Code, it does not affect the somewhat different definition of "issuer" in the Securities Law, GS 78-2 (b).

**§ 25-8-202. Issuer's responsibility and defenses; notice of defect or defense.**—(1) Even against a purchaser for value and without notice, the terms of a security include those stated on the security and those made part of the security by reference to another instrument, indenture or document or to a constitution, statute, ordinance, rule, regulation, order or the like to the extent that the terms so referred to do not conflict with the stated terms. Such a reference does not of itself charge a purchaser for value with notice of a defect going to the validity of the security even though the security expressly states that a person accepting it admits such notice.

(2)(a) A security other than one issued by a government or governmental agency or unit even though issued with a defect going to its validity is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of constitutional provisions in which case the security is valid in the hands of a subsequent purchaser for value and without notice of the defect.

(b) The rule of subparagraph (a) applies to an issuer which is a government or governmental agency or unit only if either there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(3) Except as otherwise provided in the case of certain unauthorized signatures on issue (§ 25-8-205), lack of genuineness of a security is a complete defense even against a purchaser for value and without notice.

(4) All other defenses of the issuer including nondelivery and conditional delivery of the security are ineffective against a purchaser for value who has taken without notice of the particular defense.

(5) Nothing in this section shall be construed to affect the right of a party to a "when, as and if issued" or a "when distributed" contract to cancel the contract in the event of a material change in the character of the security which is the subject of the contract or in the plan or arrangement pursuant to which such security is to be issued or distributed. (1899, c. 733, ss. 23, 28, 56, 57, 61, 62; Rev., ss. 2171, 2176, 2205, 2206, 2210, 2211; C. S., ss. 3003, 3008, 3037, 3038, 3042, 3043; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provisions:** Sections 16, 23, 28, 56, 57, 60, 61, 62, Uniform Negotiable Instruments Law.

**Changes:** Rules as to notice of defects or defenses, rights of purchasers, and the liability of primary parties applied to securities.

#### Purposes:

In this Article the rights of the purchaser for value without notice are divided into two aspects, those against the issuer, and those against other claimants to the security. Part 2 of this Article, and especially this section, deals with rights against the issuer.



1. Subsection (1) states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security) to include terms incorporated by adequate reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms. Thus, the standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate refers in some manner to the charter or articles of incorporation of the issuer. At least where there is more than one class of stock authorized applicable corporation codes specifically require a statement or summary as to preferences, voting powers and the like. References to constitutions, statutes, ordinances, rules, regulations or orders are not so common except in the obligations of governments or governmental agencies or units; but where appropriate they fit into the rule here stated.

The last sentence of subsection (1) distinguishes between the right of the issuer to incorporate by reference and the effect of that procedure as notice to a purchaser for value of a defect going to the validity of the security. Here the underlying concept is that it is for the issuer, not for the purchaser, to make sure that the issuer's security complies with the law governing its issue, and the rules as to defenses available to the issuer are stated in the following subsections.

2. By subsection (2) a security "is valid" in the hands of a purchaser for value without notice of a particular defect even if the defect is so serious as to be described as one "going to the validity" of the security. The few exceptions to this proposition are noted later. Notice that "purchaser" includes a person taking from the company on original issue (Section 1—201) whereas a "subsequent purchaser" does not (Section 8—102).

3. Subsection (2) does not touch the relationship between the issuer and a purchaser who takes on original issue when the defect in issue consists of the violation of a constitutional provision. That situation is not covered by this Article but is left to the law of the particular state.

Following the basic principles of the Negotiable Instruments Law the cases have generally held that an issuer is estopped from denying representations made in the text of a security. *Delaware-New Jersey Ferry Co. v. Leeds*, 21 Del.Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. *Bonini*

*v. Family Theatre Corporation*, 327 Pa. 273, 194 A. 498 (1937); *First National Bank of Fairbanks v. Alaska Automotive*, 119 F.2d 267 (C.C.A.Alaska 1941).

This general rule of estoppel is here adopted in favor of purchasers, with the exception noted above.

The genuineness of an instrument, on the other hand, has always been subject to attack and this rule is continued in subsection (3) with the stated exception provided for in the case of certain unauthorized signatures (Section 8—205).

Instead of allowing damages against the issuer, subsection (2) validates most defective securities in the hands of innocent purchasers, thus refusing to prefer such a purchaser over other investors of the same class while keeping the benefit of the investment available to him.

4. Many jurisdictions have constitutional and statutory requirements that unless substantial value is received by the issuer for the security it shall be void. This Article follows the better case law and validates securities in the hands of bona fide purchasers where the provisions are statutory and bona fide subsequent purchasers where the provisions are constitutional, even where this type of defect exists. See as to constitutional provisions, *Kisterbock's Appeal*, 127 Pa. 601, 18 A. 381, 14 Am.St.Rep. 868 (1889); *Clark v. Freeling*, 196 Ark. 907, 120 S.W.2d 375 (1938); *People's State Bank v. Jacksonian Hotel Co.*, 261 Ky. 166, 87 S.W.2d 111 (1935); *O'Brien v. Turner*, 174 Wash. 266, 24 P.2d 641 (1933); and as to statutory requirements, *Westminster National Bank v. New England Electrical Works*, 73 N. H. 465, 62 A. 971, 3 L.R.A., N.S., 551, 111 Am.St.Rep. 637 (1906); *Bankers Trust Co. v. Rood*, 211 Iowa 289, 233 N.W. 794, 73 A.L.R. 1421 (1930). Lesser defects in issue a fortiori received the same treatment.

5. Although generally regarded as a defect going to the validity of the security overissue is an exception to the rule of subsection (2) (Section 8—104) and an issuer cannot be required to recognize a security which constitutes an overissue. The provisions of the section on overissue (Section 8—104) require, however, that if a similar security is reasonably available for purchase, the issuer must purchase and deliver it to the purchaser in place of the invalid one.

6. Governmental issuers are distinguished in subsection (2) from other issuers as a matter of public policy and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting

defenses only if there has been substantial compliance with the legal requirements governing the issue or if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e. g., in the manner of publishing election notices, shall not be a ground for depriving an innocent purchaser of his rights in the security. The policy is here adopted of such cases as *Tommie v. City of Gadsden*, 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute.

A long and well established line of Federal cases recognizes the principle of estoppel in favor of bona fide purchasers where municipalities issue bonds containing recitals of compliance with governing constitutional and statutory provisions, made by the municipal authorities entrusted with determining such compliance. *Chaffee County v. Potter*, 142 U.S. 355, 12 S.Ct. 216, 35 L.Ed. 1040 (1892); *Oregon v. Jennings*, 119 U.S. 74, 7 S.Ct. 124, 30 L.Ed. 323 (1886); *Gunnison County Commissioners v. Rollins*, 173 U.S. 255, 19 S.Ct. 390, 43 L.Ed. 689 (1898). This rule has been qualified, however, by requiring that the municipality have power to issue the security. *Anthony v. County of Jasper*, 101 U.S. 693, 25 L.Ed. 1005 (1879); *Town of South Ottawa v. Perkins*, 94 U.S. 260, 24 L.Ed. 154 (1876). This section follows the case law trend, simplifying the rule by set-

ting up two conditions for an estoppel against a governmental issuer: (1) substantial consideration given, and (2) power in the issuer to borrow money or issue the security for the stated purpose. As a practical matter the problem of policing governmental issuers has been alleviated by the present practice of requiring legal opinions as to the validity of the issue. The bulk of the case law on this point is nearly 50 years old and it may be assumed that the question now seldom arises.

7. Subsection (5) is included to make clear that this section does not affect the presently recognized right of either party to a "when, as and if" or "when distributed" contract to cancel the contract on substantial change.

#### Cross references:

Point 1: Sections 1—201, 8—203.

Point 2: Sections 1—201, 8—102.

Point 3: Section 8—205.

Point 5: Section 8—104.

See Sections 8—104, 8—203, 8—205 and 8—206.

#### Definitional cross references:

"Delivery". Section 1—201.

"Genuine". Section 1—201.

"Issuer". Section 8—201.

"Money". Section 1—201.

"Notice". Section 1—201.

"Organization". Section 1—201.

"Person". Section 1—201.

"Proper form". Section 8—102.

"Purchaser". Section 1—201.

"Security". Section 8—102.

"Subsequent purchaser". Section 8—102.

"Term". Section 1—201.

"Unauthorized signature". Section 1—201.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1)* validates the common practice of reciting terms not only in the security itself but also in an often lengthy side instrument, such as an indenture or mortgage, which is incorporated by reference into the security. Thus, the indenture may contain terms not recited in the security; the only Code requirement is that the terms of the security and side instrument be consistent. To the extent that the NIL, made nonnegotiable a bond which was subject to terms in another instrument, cf. *Pope v. Righter Parey Lumber Co.*, 162 N.C. 206, 78 S.E. 65 (1913) (note), the Code changes prior law.

*Subsection (2)* states the circumstances under which an issuer's defenses will be extinguished when the instrument is held by a bona fide purchaser. Bona fide pur-

chasers of nongovernmental securities are generally immunized from defenses, but only subsequent bona fide purchasers (see GS 25-8-102 (2)) take free of constitutional defects. GS 25-8-202 (2) (a). Additional conditions must be met to extinguish defenses of governmental issuers: Either the governmental unit must have substantially met all legal requirements or it must have received substantial consideration for securities which it was empowered to issue. GS 25-8-202 (2) (b). The North Carolina case law substantially accords with these Code rules.

In general, a bona fide purchaser of a security can cut defenses of the issuer. See, e.g., *Bankers Trust Co. v. City of Statesville*, 203 N.C. 399, 166 S.E. 169 (1932); *Belo v. Commissioners of Forsyth County*,

76 N.C. 489 (1877). However, "a careful distinction should be drawn between the want of power to issue bonds, and mere irregularities in the exercise of that power. The latter, under certain circumstances, may be cured by recitals or eliminated by estoppel; but a want of power goes to the very root of the transaction, and destroys its vitality." *Commissioners of Wilkes County v. Call*, 123 N.C. 308, 31 S.E. 481 (1898). As against a bona fide purchaser, a municipality cannot assert that the bonds were authorized at a special rather than a regular alderman's meeting. *Bankers Trust Co. v. City of Statesville*, 203 N.C. 399, 166 S.E. 169 (1932), or plead a nonsubstantial deficiency in the conduct or result of the election, *Reiger v. Commissioners of Town of Beaufort*, 70 N.C. 319 (1874); *Smith v. Town of Belhaven*, 150 N.C. 156, 63 S.E. 610 (1909), or the bonds were issued by de facto town officers, *Smith v. Carolina Beach*, 206 N.C. 834, 175 S.E. 313 (1934), or were not signed by all the incumbent commissioners, *Bank of Statesville v. Town of Statesville*, 84 N.C. 169 (1881). Under the Code, as under prior North Carolina law, the clear test is one of substantial compliance with the formalities of the statute. *Wilmington, O. & E. C. R.R. v. Commissioners of Onslow County*, 116 N.C. 563, 21 S.E. 205 (1895); *Hill v. Skinner*, 169 N.C. 405, 86 S.E. 351 (1915); *Commissioners of Hendersonville v. C. N. Malone & Co.*, 179 N.C. 604, 103 S.E. 134 (1920). On questions of compliance with statutorily required procedure, recitals in the instrument are conclusive in favor of the bona fide purchaser, although a defective recital may be notice to a purchaser of defenses. *Claybrook v. Commissioners of Rockingham County*, 114 N.C. 453, 19 S.E. 593 (1894).

North Carolina decisions uniformly hold that defenses based on noncompliance with a constitutional requirement are available against any bona fide purchaser, *Union Bank v. Commissioners of Town of Oxford*, 119 N.C. 214, 35 S.E. 966 (1896); *Glenn v. Wray*, 126 N.C. 730, 36 S.E. 167 (1900), and the municipality's recognition of the unconstitutional obligation by paying interest does not preclude later assertion of the defense, *Commissioners of Stanly County v. Snuggs*, 121

N.C. 394, 28 S.E. 539 (1897), for "there can be no bona fide holders of unconstitutional obligations," *Debnam v. Chitty*, 131 N.C. 657, 43 S.E. 3 (1902). See also *Baltzer v. State*, 104 N.C. 265, 10 S.E. 153 (1889) (all claims growing out of an unconstitutional obligation are unenforceable). GS 25-8-202 (2) (b) slightly modifies this rule since it sustains, in the hands of subsequent bona fide purchasers (see GS 25-8-102 (2)), a governmental security with a constitutional defect if the issuer has received substantial consideration and if, further, the issuer had power to issue securities for that purpose. This would apparently overrule several old decisions voiding bond issues for noncompliance with a constitutionally required procedure (as distinguished from a lack of power to issue the bonds for a stated purpose). See, e.g., *Union Bank v. Commissioners of Town of Oxford*, 119 N.C. 214, 35 S.E. 966 (1896); *Glenn v. Wray*, 126 N.C. 730, 36 S.E. 167 (1900); and *Commissioners of Stanly County v. Snuggs*, 121 N.C. 394, 28 S.E. 539 (1897) (voiding bonds for noncompliance with a constitutional requirement of entering yeas and nays in legislative journals).

*Subsection (4)* accords with North Carolina decisions. *Bankers Trust Co. v. City of Statesville*, 203 N.C. 399, 166 S.E. 169 (1932) (defense of nondelivery of bonds rejected); *Smith v. Town of Belhaven*, 150 N.C. 156, 63 S.E. 610 (1909) (rejecting defense of improper use of bond proceeds); *Hightower v. City of Raleigh*, 150 N.C. 569, 65 S.E. 279 (1909) (same); *Parker v. Flora*, 63 N.C. 474 (1869) (lack or failure of consideration held no defense against bona fide purchaser).

GS 25-8-202 does not preclude or limit actions by taxpayers, prior to issue of governmental bonds, questioning the validity of the issue or the procedure by which they are issued. The Code rules apply only to the availability of defenses when the securities have been issued and are held by bona fide purchasers. In recent years contests between governmental issuers and purchasers have markedly declined due to greater care in authorizing the bonds and the common practice of securing firm opinions from counsel as to the validity of the bonds.

**§ 25-8-203. Staleness as notice of defects or defenses.**—(1) After an act or event which creates a right to immediate performance of the principal obligation evidenced by the security or which sets a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer



(a) if the act or event is one requiring the payment of money or the delivery of securities or both on presentation or surrender of the security and such funds or securities are available on the date set for payment or exchange and he takes the security more than one year after that date; and

(b) if the act or event is not covered by paragraph (a) and he takes the security more than two years after the date set for surrender or presentation or the date on which such performance became due.

(2) A call which has been revoked is not within subsection (1). (1899, c. 733, ss. 52, 53; Rev., ss. 2201, 2202; C. S., ss. 3033, 3034; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 52(2), 53, Uniform Negotiable Instruments Law.

**Changes:** Extensive modification of policy that a holder in due course must take before maturity of the instrument.

##### Purposes of changes:

1. The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The fact that a security is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time he can no longer claim that he had "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption of the security it is normally turned in more promptly and a shorter time is set as the "reasonable period", subsection (1) (a), than is set where funds are not available.

It is true that defaulted securities are frequently traded on financial markets in the same manner as unmatured and defaulted instruments and a purchaser might

not be placed upon notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes "stale" two years after the default. But notice that a different rule applies when the question is notice not of issuer's defenses but of claims of ownership. Section 8—305 and comment.

2. Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock" beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

##### Cross references:

See Sections 8—104(1), 8—202 and 8—305.

##### Definitional cross references:

"Delivery". Section 1—201.

"Issuer". Section 8—201.

"Money". Section 1—201.

"Notice". Section 1—201.

"Purchaser". Section 1—201.

"Right". Section 1—201.

"Security". Section 8—102.

#### NORTH CAROLINA COMMENT

It is not uncommon for bonds to continue in circulation after a default, or for shares to trade after a redemption or conversion date has passed. Because investment securities are thus frequently traded, even though overdue, GS 25-8-203 changes the traditional rule of the NIL that a post-maturity purchaser cannot be a holder in due course of the security. See

Belo v. Commissioners of Forsyth County, 76 N.C. 489 (1877), applying the old rule to overdue municipal bonds. The effect of the Code rule is to permit purchasers to acquire overdue securities, for specified periods of time, free of issuer defenses. A similar rule applies in the case of equities of ownership. GS 25-8-305.

**§ 25-8-204. Effect of issuer's restrictions on transfer.**—Unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it. (1941, c. 353, s. 15; G. S., s. 55-95; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 15, Uniform Stock Transfer Act.

**Changes:** Rephrased.

##### Purposes of changes:

1. "Noted" removes an ambiguity under the former Act and makes clear that the

restriction need not be set forth in full text. See *Allen v. Biltmore Tissue Corporation*, 2 N.Y.2d 534, 141 N.E.2d 812 (1957).

Securities dealt in on financial markets are generally assumed to be free of adverse claims (Section 8—301). That assumption should not be lightly negated. Therefore a strict rule as to notice of a restriction on transfer is here imposed. Since by hypothesis the issuer imposed the restriction, the refusal of an issuer to register a transfer on the basis of an unnoted restriction constitutes a conversion and the issuer can be compelled to register the transfer under the policy of Part 4 of this Article. *Hulse v. Consolidated Quicksilver Mining Corporation*, 65 Idaho 768, 154 P.2d 149 (1944); *Mancini v. Patrizi*, 110 Cal.App. 42, 293 P. 828 (1930). Conversely, the issuer to whom a security with proper notation of a restriction is presented thereby receives timely notification of an adverse claim and is under a duty to inquire (Section 8—403).

A purchaser with actual knowledge of an unnoted restriction certainly has notice of an adverse claim (Section 8—304 and Comment). In that situation this section adopts the reasoning of *Baumohl v. Goldstein*, 95 N.J.Eq. 597, 124 A. 118 (1924), and *Tomoser v. Kamphausen*, 307 N.Y. 797, 121 N.E.2d 622 (1954), rejecting the contrary holding of such cases as *Costello v. Farrell*, 234 Minn. 453, 48 N.W.2d 557, 29 A.L.R.2d 890 (1951).

2. Most jurisdictions recognize the right of issuers to impose restrictions giving either the issuer itself or other stockholders the option to purchase the security at an ascertained price before it is offered to third parties. *Vannucci v. Peduni*, 217 Cal. 138, 17 P.2d 706 (1932); *People ex rel. Rudaitis v. Galskis*, 233 Ill.App. 414, (1924); *Bloomington v. Bloomington*, 107 Misc. 646, 177 N.Y.S. 873 (1919). This is the type of restriction contemplated by the present section. Mere notation on the security cannot, of course, validate an otherwise unlawful restriction. The present section in no way alters the prevailing case law which recognizes free alienability as an inherent attribute of securities and holds invalid unreasonable restraints on alienation such as those requiring consents of directors without establishing criteria for the granting or withholding of such consents and those giving the directors an option of purchase at a price to be fixed in their sole discretion. *Howe v. Roberts*, 209 Ala. 80, 95 So. 344 (1923); *People ex rel. Malcolm v. Lake Sand Corporation*, 251 Ill.App. 499 (1929); *Morris v. Hus-*

*song Dyeing Machine Co.*, 81 N.J.Eq. 256, 86 A. 1026 (1913); *New England Trust Co. v. Abbott*, 162 Mass. 148, 38 N.E. 432, 27 L.R.A. 271.

Nor is interference intended with such statutory provisions as typified by Section 66 of the New York Stock Corporation Law (which permits the directors to refuse to transfer the shares of a stockholder indebted to the corporation when such restriction is printed on the certificate) or by Chapter 276, Section 14, of the New Hampshire Revised Laws of 1942 (which prohibits any corporation from making any by-law restraining the free sale of shares of its stock).

No interference is intended with the common practice of closing books for proper corporate purposes.

3. Cooperative associations and ventures, as well as private clubs are generally considered an exception to the rules against restrictions on transfer as unreasonable restraints on alienation and are permitted for example to require the consents of governing bodies such as a board of directors. *Penthouse Properties, Inc. v. 1158 Fifth Avenue, Inc.*, 256 App.Div. 685, 11 N.Y.S. 2d 417 (1939).

Historically restrictions on transfer were most commonly imposed by so-called "closely-held" issuers (including cooperatives and the like) in an attempt to restrict control if not total membership to a homogeneous security holder group. They are being increasingly resorted to today by issuers with publicly held securities seeking to police enforcement of the registration requirements of the Securities Act of 1933 against persons purchasing their securities in a transaction exempt from those requirements (e. g., one "not involving any public offering" [Securities Act of 1933, Section 4(1)]) or against persons in a "control" relationship to the issuer. [Securities Act of 1933. Section 2(11) and see Rule 405 of the Rules and Regulations of the Securities and Exchange Commission under that Act.] Particularly in the latter context where notation of the restriction on all affected certificates may not be practical the issuer enforces it by notifying the holders of such certificates and refusing requests to register transfer out of the name of the "controlling person" either for purposes of sale or for delivery after sale, relying on the stated exception as to a person "with actual knowledge" of the restriction.

4. This section deals only with restrictions imposed by the issuer and restrictions imposed by statute are not affected. See *Quiner v. Marblehead Social Co.*, 19

Mass. 476 (1813); *Madison Bank v. Price*, 79 Kan. 289, 100 P. 280 (1909); *Healey v. Steele Center Creamery Ass'n*, 115 Minn. 451, 133 N.W. 69 (1811). Nor does it deal with private agreements between stockholders containing restrictive covenants as to the sale of the security as in *In re Consolidated Factors Corporation*, 46 F.2d 561 (D.C.N.Y.1931).

#### NORTH CAROLINA COMMENT

GS 25-8-204 extends to all securities the requirement of the Uniform Stock Transfer Act that transfer restrictions appear upon the certificate, although actual knowledge of the transfer restriction is legally equivalent to a notation of the restriction. Whether or not a restriction is "otherwise lawful" under GS 25-8-204 depends, not on the Code, but on the substantive law of corporations and property. Thus, buy-and-sell agreements and first option arrangements are normally sustained, and *Wright v. Iredell Tel. Co.*, 182 N.C. 308, 108 S.E. 744 (1921), upheld a requirement

5. A corresponding provision concerning issuer's liens appears at Section 8—103.

#### Cross references:

Point 5: Section 8—103.

See Part 4 of this Article.

#### Definitional cross references:

"Conspicuous". Section 1—201.

"Issuer". Section 8—201.

"Security". Section 8—102.

that directors consent to a proposed transfer of shares. An absolute restraint on alienating stock or other securities would presumably not be "otherwise lawful" and therefore ineffective even if "conspicuously noted" on the security. Since GS 25-8-204 applies only to restrictions "imposed by the issuer," private agreements among shareholders, not involving the corporation, are not covered by this provision. In this respect, the Code is narrower in scope than the corresponding Stock Transfer Act provision.

**§ 25-8-205. Effect of unauthorized signature on issue.**—An unauthorized signature placed on a security prior to or in the course of issue is ineffective except that the signature is effective in favor of a purchaser for value and without notice of the lack of authority if the signing has been done by

(a) an authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security or of similar securities or their immediate preparation for signing; or

(b) an employee of the issuer or of any of the foregoing entrusted with responsible handling of the security. (1899, c. 733, s. 23; Rev., s. 2171; C. S., s. 3003; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 23, Uniform Negotiable Instruments Law.

**Changes:** Rephrased; circumstances under which an issuer is precluded from setting up a forgery as a defense made explicit.

#### Purposes of changes:

1. In current practice the problem of forged or unauthorized signatures arises most frequently where an employee of the issuer, transfer agent or registrar has access to securities which he is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. This section is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they have held out to the public as authorized to prepare such securities. See *Fifth Avenue Bank of New York v. The Forty-Second & Grand Street Ferry Railroad Co.*, 137 N.Y. 231, 33 N.E. 378, 19

L.R.A. 331, 33 Am.St.Rep. 712 (1893); *Jarvis v. Manhattan Beach Co.*, 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). The "apparent authority" concept of some of the case-law, however, is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where the forger signs a signature he is authorized to sign under proper circumstances and those in which he signs a signature he is never authorized to sign. *Citizens' & Southern National Bank v. Trust Co. of Georgia*, 50 Ga.App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign and which he has not. The issuer, on the other hand can protect himself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel.



2. The issuer cannot be held liable for the honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities and whose possible commission of forgery it has no reason to anticipate. The result in such cases as *Hudson Trust Co. v. American Linseed Co.*, 232 N.Y. 350, 134 N.E. 178 (1922), and *Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co.*, 213 Pa. 307, 62 A. 916, 5 Ann.Cas. 248 (1906) is here adopted.

3. The present section deals only with signatures placed upon securities prior to or in the course of issue and is not concerned with forged or unauthorized indorsements (Section 8—311).

4. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

**Cross references:**

Point 3: Section 8—311.

See Section 8—202(3).

**Definitional cross references:**

"Issuer". Section 8—201.

"Notice". Section 1—201.

"Person". Section 1—201.

"Purchaser". Section 1—201.

"Security". Section 8—102.

"Sign". Section 1—201.

"Unauthorized signature". Section 1—201.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

Although an unauthorized signature normally does not bind the issuer under GS 25-8-205, it will be effective in favor of a bona fide purchaser if made by a transfer agent or registrar or its responsible personnel, or by an officer of the issuer. This takes account of the frequent corporate practice of keeping on hand unissued stock and bond certificates which have been signed by appropriate personnel, or which can readily be countersigned or otherwise validated by individuals entrusted with the certificates. Compare GS

55-57 (b). The Code rule accords with *Havens v. Bank of Tarboro*, 132 N.C. 214, 43 S.E. 639 (1903), which sustained, in favor of the innocent purchaser for value, stock certificates which had been signed by the corporation's officers and entrusted to an employee who subsequently issued them to himself to use as collateral for a personal loan. The theory of the case—that the negligent corporation rather than the innocent purchaser should bear the loss—is the basis for the Code rule.

**§ 25-8-206. Completion or alteration of instrument.**—(1) Where a security contains the signatures necessary to its issue or transfer but is incomplete in any other respect

(a) any person may complete it by filling in the blanks as authorized; and

(b) even though the blanks are incorrectly filled in, the security as completed is enforceable by a purchaser who took it for value and without notice of such incorrectness.

(2) A complete security which has been improperly altered even though fraudulently remains enforceable but only according to its original terms. (1899, c. 733, ss. 14, 15, 124; Rev., ss. 2164, 2165, 2274; C. S., ss. 2995, 2996, 3106; 1941, c. 353, s. 16; G. S., s. 55-96; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 14, 15 and 124, Uniform Negotiable Instruments Law; Section 16, Uniform Stock Transfer Act.

**Changes.**

1. Non-delivery of an incomplete instrument is no longer available as a defense against a purchaser for value without notice.

2. An altered security may now be enforced according to its original terms by any holder.

**Purposes of changes:**

1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security is not involved here

and a person in possession of a security is not, by this section, given authority to fill in blanks with such signatures.

2. Blanks left upon the issue of a security are the only blanks dealt with here and a purchaser for value without notice is protected. Blanks on assignments or powers of attorney during the transfer of a security and the holding in *Meier v. Continental Nat. Bank*, 83 Ind.App. 109, 143 N.E. 377 (1924) giving the transferee implied power to fill in such blanks are covered by provisions of this Article on indorsement, Section 8—308. The problem in those cases is one of claims of ownership rather than of issuer's defenses, and

the rights of a purchaser are determined under the provisions of this Article on bona fide purchase (Section 8—301).

3. The defense of non-delivery is not available to an issuer against a purchaser for value without notice (subsection (4) of Section 8—202). Normally undelivered securities containing blanks can be appropriated and filled up only by employees and agents of the issuer who have access to such unissued securities. As in the case of forged or unauthorized signatures on issue, the issuer must bear the responsibility for trusting such persons.

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is filled in a blank (Section 8—104).

5. The nature of securities and the investment normally involved necessitates that any purchaser of an altered security be permitted to enforce it according to its original terms whether or not he be a purchaser for value without notice.

**Cross references:**

Point 2: Sections 8—301 and 8—308.

Point 3: Section 8—202(4).

Point 4: Section 8—104.

See Sections 8—205 and 8—311.

**Definitional cross references:**

“Notice”. Section 1—201.

“Person”. Section 1—201.

“Purchaser”. Section 1—201.

“Security”. Section 8—102.

“Term”. Section 1—201.

“Value”. Section 1—201.

**NORTH CAROLINA COMMENT**

Since GS 25-8-202 (4) abolishes the defense of nondelivery of a security, and GS 25-8-206 (1) permits an instrument to be completed, the effect is to change the rule of the NIL, GS 25-21, that nondelivery of an incomplete instrument is a defense against a purchaser for value without notice. Thus, under GS 25-8-206, whether or not delivered, the purchaser may enforce the instrument if blanks have been filled in as authorized or even if the blanks have been incorrectly filled up provided the purchaser was unaware of this fact.

GS 25-8-206 (2) reverses the rule of the NIL, GS 25-131, that only a holder in due course may enforce a materially altered security, by authorizing any holder to enforce the security according to its original tenor. Although overturning the NIL doctrine, GS 25-8-206 (2) substantially accords with the rule of § 16 of the Uniform Stock Transfer Act, GS 55-90, and extends its rule to all securities. The effect, thus, is to eliminate different rules for bonds and shares of stock under prior law.

**§ 25-8-207. Rights of issuer with respect to registered owners. —**  
(1) Prior to due presentment for registration of transfer of a security in registered form the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, to receive notifications and otherwise to exercise all the rights and powers of an owner.

(2) Nothing in this article shall be construed to affect the liability of the registered owner of a security for calls, assessments or the like. (1941, c. 353, s. 3; G. S., s. 55-83; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 3, Uniform Stock Transfer Act.

**Changes:** Issuer's rights with respect to registered holders now stated affirmatively and express protection given until the security is duly presented for registration of transfer.

**Purposes of changes:**

1. The protection of this section operates until due presentment of the security for registration of transfer; what constitutes such “due presentment” is determined generally by Part 4 of this Article dealing with Registration. The rule of such cases as *Turnbull v. Longacre Bank*, 249 N.Y. 159, 163 N.E. 135 (1928), which held the issuer liable for paying out dividends to the record holder after the transferee had

given notice of the transfer and demanded that a new certificate be issued to him, is left unchanged. However, such cases as *Morrison v. Gulf Oil Corporation*, 189 Miss. 212, 196 So. 247 (1940), holding that Section 3 of the Uniform Stock Transfer Act did not change the common law as to the issuer's liability for dealing with the record holder after mere notice of a pledge, are expressly rejected. Mere notice is not enough under this section to impose upon the issuer the duty of dealing with the pledgee although it may constitute notice to the issuer of a claim of ownership under Part 4.

2. Subsection (1) is permissive and does not require that the issuer deal exclusively with the registered owner. It is free

to require proof of ownership before paying out dividends or the like if it chooses to. *Barbato v. Breeze Corporation*, 128 N.J.L. 309, 26 A.2d 53 (1942).

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which will be definitive as between them.

4. No change in existing state laws as to the liability of registered owners for calls and assessments is here intended nor is anything in this section designed to estop a record holder from denying ownership when assessments are levied if he is otherwise entitled to do so under state

law. See *State ex rel. Squire v. Murfey, Blosson & Co.*, 131 Ohio St. 289, 2 N.E. 2d 866 (1936); *Willing v. Delaplaine*, 23 F.Supp. 579 (1937).

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting and other purposes, as provided for in by-laws, charters and statutes.

#### Cross reference:

See Part 4 of this Article.

#### Definitional cross references:

"Issuer". Section 8—201.

"Notification". Section 1—201.

"Person". Section 1—201.

"Registered form". Section 8—102.

"Right". Section 1—201.

"Security". Section 8—102.

### NORTH CAROLINA COMMENT

GS 25-8-207 (1) extends to all securities the prior North Carolina rule under § 3 of the Uniform Stock Transfer Act, GS 55-77. It is thus consistent with provisions in the Business Corporation Law which permit the corporation to look solely to the registered owner of shares, GS 55-59, for the purpose of establishing a record date and closing the stock transfer books, GS 55-60 (a), (b), giving notice of meetings, GS 55-62 (a), paying dividends and making other distributions, or making any other determination of shareholders, GS

55-60 (a), (b). See *Bleakley v. Candler*, 169 N.C. 16, 84 S.E. 1039 (1915). It does not, however, preclude a court from making a determination that shareholders not of record are entitled to vote, GS 55-71 (h) (3), or to enjoy other beneficial interests instead of the holder of record, e.g., where shares have been purchased after a record date or are held in "street name."

GS 25-8-207 (2) saves the shareholder liabilities under the Business Corporation Law, GS 55-53.

**§ 25-8-208. Effect of signature of authenticating trustee, registrar or transfer agent.**—(1) A person placing his signature upon a security as authenticating trustee, registrar, transfer agent or the like warrants to a purchaser for value without notice of the particular defect that

(a) the security is genuine; and

(b) his own participation in the issue of the security is within his capacity and within the scope of the authorization received by him from the issuer; and

(c) he has reasonable grounds to believe that the security is in the form and within the amount the issuer is authorized to issue.

(2) Unless otherwise agreed, a person by so placing his signature does not assume responsibility for the validity of the security in other respects. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:**  
None.

#### Purposes:

1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See *Jarvis v. Manhattan Beach Co.*, 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws

and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a security without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefore been made explicit in terms of due care. See *Feldmeier v. Mortgage Securities, Inc.*, 34 Cal.App.2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent



misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. *Ainsa v. Mercantile Trust Co.*, 174 Cal. 504, 163 P. 898 (1917); *Tschetinian v. City Trust Co.*, 186 N.Y. 432, 79 N.E. 401 (1906); *Davidge v. Guardian Trust Co. of New York*, 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar or transfer agent. See, for example, the Federal Reserve Act (U.S.C.A., Title 12, Banks and Banking, Section 248) under which the Board of Governors of the Federal Reserve Bank is authorized to grant special permits to National Banks permitting them to act as trustees. Such corporations are therefore held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars and transfer agents have normally been held liable for an issue in excess of the authorized amount. *Jarvis v. Manhattan Beach Co.*, supra, *Mullen v. Eastern Trust & Banking Co.*, 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not necessarily validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from the question of excess issue these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected. See *Fifth Ave. Bank v. Forty-Second Street & Grand Street Ferry R. Co.*, 137 N.Y. 231, 240, 33 N.E. 378, 380, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893).

6. This provision does not prevent a transfer agent or issuer agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a security signed by the issuer or the transfer agent or both. Nor does it interfere with proper indemnity arrangements between the issuer and trustees, transfer agents, registrars and the like.

#### Cross reference:

Point 1: Section 8—102.

#### Definitional cross references:

"Agreed". Section 1—201.

"Genuine". Section 1—201.

"Issuer". Section 8—201.

"Notice". Section 1—201.

"Person". Section 1—201.

"Proper form". Section 8—102.

"Purchaser". Section 1—201.

"Security". Section 8—102.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

GS 25-8-208 (1) specifically states the warranties given by a person signing a security to a purchaser for value without notice of the defect, e.g., signers of stock certificates under the Business Corporation Law, GS 55-57 (b). Although no North Carolina decisions deal with these warranties, a line of authoritative New York decisions is in accord with the Code, and it is believed that these rulings would have been followed in North Carolina.

*Jarvis v. Manhattan Beach Co.*, 148 N.Y. 652, 43 N.E. 68 (1896). The Code warranty of the signer's authority, GS 25-8-208 (1) (b), accords with common-law agency rules. GS 25-8-208 (2) accurately states the accepted view that, unless otherwise agreed by the parties, one signing a security does not warrant the validity of a security, e.g., that it is free of defects going to its validity under a statutory or constitutional provision.

### PART 3.

#### PURCHASE.

§ 25-8-301. Rights acquired by purchaser; "adverse claim"; title acquired by bona fide purchaser.—(1) Upon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actual authority to convey except that a purchaser who has himself been a party to any fraud or illegality affecting the security or who as a prior holder had notice of an adverse claim cannot improve his position by taking from a later bona fide purchaser. "Adverse claim" includes a claim that a transfer was or would be wrongful

or that a particular adverse person is the owner of or has an interest in the security.

(2) A bona fide purchaser in addition to acquiring the rights of a purchaser also acquires the security free of any adverse claim.

(3) A purchaser of a limited interest acquires rights only to the extent of the interest purchased. (1899, c. 733, ss. 52, 57 to 59; Rev., ss. 2201, 2206 to 2208; C. S., ss. 3033, 3038 to 3040; 1941, c. 353, ss. 6, 7; G. S., ss. 55-86, 55-87; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 52, 57, 58 and 59, Uniform Negotiable Instruments Law; Section 7, Uniform Stock Transfer Act.

**Changes:** Rephrased; policy made uniform for all investment securities.

##### Purposes of changes:

1. This Article views the concept of negotiability from two aspects: issuer's defenses and adverse claims. Any purchaser for value of a security without notice of a particular defect may take free of the issuer's defense based on that defect, but only a purchaser taking by a formally perfect transfer, for value and without notice of any adverse claim, may take free of adverse claims. The "bona fide purchaser" here dealt with is the person taking free of adverse claims. His rights against the issuer are determined by Part 2 of this Article and his rights to registration are determined by Part 4.

2. Protection is extended to bona fide purchasers of all investment securities, whether such securities were considered negotiable or non-negotiable under the prior law. This is the result sought by many cases which have resolved doubts in favor of negotiability despite terms in bonds which militated against their negotiability under the provisions of the Negotiable Instruments Law. See *Paxton v. Miller*, 102 Ind.App. 511, 200 N.E. 87 (1936); *Scott v. Platt*, 171 Or. 379, 135 P.2d 769 (1943). Such cases as *U. S. Gypsum v. Faroll*, 296 Ill.App. 47, 15

N.E.2d 888 (1938), protecting bona fide purchasers of stock certificates under the provisions of the Stock Transfer Act are adopted and approved.

3. Subsection (1) states the so-called shelter provision of the Negotiable Instruments Law as well as the exception to it in the case of a person participating in the fraud or illegality. These provisions are applicable throughout this Article and any reference to the rights of purchasers must be read as including the shelter provision and its exception. See *Gruntal v. U. S. Fidelity & Guaranty Co.*, 254 N.Y. 468, 173 N.E. 682 (1930).

4. An adverse claim may be either legal or equitable, e. g., that the claimant is the beneficial owner of a security, though not the legal owner of it, or that it has been or is proposed to be transferred in breach of trust or a valid restriction on transfer (See Section 8—204 and Comment).

##### Cross references:

Point 1: Parts 2 and 4 of this Article.

Point 4: Section 8—204 and Comment.

##### Definitional cross references:

"Bona fide purchaser". Section 8—302.

"Delivery". Section 1—201.

"Holder". Section 1—201.

"Notice". Section 1—201.

"Party". Section 1—201.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Purchaser". Section 1—201.

"Rights". Section 1—201.

"Security". Section 8—102.

#### NORTH CAROLINA COMMENT

Under GS 25-8-301, every purchaser of a security obtains at least such rights as his transferor was entitled to convey, so that ownership claims against the transferor may be asserted against the transferee. This accords with the NIL, GS 25-64, and with a dictum in *Belo v. Commissioners of Forsyth County*, 76 N.C. 489 (1877) (defenses of issuer). If the transferor was a bona fide purchaser, the transferee of a negotiable bond may be entitled to assert the transferor's rights to extinguish ownership claims. See *Wellons v. Warren*, 203 N.C. 178, 165 S.E. 545 (1932)

(negotiable note). GS 25-8-301 (2)'s statement that a bona fide purchaser (the equivalent of a holder in due course under the NIL) extinguishes adverse claims of ownership accords with prior law, both as to bonds, *Stricker v. Buncombe County*, 205 N.C. 536, 172 S.E. 188 (1934), and as to stock certificates, both before the enactment of the Uniform Stock Transfer Act, see *Castellote v. Jenkins*, 186 N.C. 166, 119 S.E. 202 (1923); *Zeiger v. Stephenson*, 153 N.C. 528, 69 S.E. 611 (1910); *Cox v. Dowd*, 133 N.C. 537, 45 S.E. 846 (1903), and since its enactment, GS 55-81;

Scottish Bank v. Atkinson, 245 N.C. 563, 96 S.E.2d 837 (1957).

The term "adverse interest" as used in article 8 is not defined, but is intended to include all legal and equitable interests

in a security. Compare the definition of "claim of beneficial interest" in the Uniform Act for Simplification of Fiduciary Security Transfers, GS 32-14 (2).

**§ 25-8-302. "Bona fide purchaser."**—A "bona fide purchaser" is a purchaser for value in good faith and without notice of any adverse claim who takes delivery of a security in bearer form or of one in registered form issued to him or indorsed to him or in blank. (1899, c. 733, s. 52; Rev., s. 2201; C. S., s. 3033; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 52, Negotiable Instruments Law.

**Purposes:** To define the bona fide purchaser who has the rights stated in the preceding section. Note that there may be claims of ownership which are not "adverse", e. g., the claim of a principal against his agent including that of a customer against his broker (Section 8-303). The agent's knowledge of his principal's claim thus cannot defeat the agent's right to be a bona fide purchaser under this section.

#### Definitional cross references:

"Adverse claim". Section 8-301.

"Bearer form". Section 8-102.

"Delivery". Section 1-201.

"Good faith". Section 1-201.

"Indorsed". Section 8-308.

"Notice". Section 1-201.

"Purchaser". Section 1-201.

"Registered form". Section 8-102.

"Security". Section 8-102.

"Value". Section 1-201.

#### NORTH CAROLINA COMMENT

In general, the bona fide purchaser of an investment security is the equivalent of a holder in due course under the NIL, GS 25-58, and to the "purchaser for value in good faith without notice of any facts making the transfer wrongful" under the Uniform Stock Transfer Act, GS 55-81

(a). Although it provides uniform usage, the Code definition does not alter prior law in substance, except so far as the "bona fide purchaser" of an investment security, unlike the holder in due course, need not take the security before maturity. Compare GS 25-58 (2) with GS 25-8-304.

**§ 25-8-303. "Broker."**—"Broker" means a person engaged for all or part of his time in the business of buying and selling securities, who in the transaction concerned acts for, or buys a security from or sells a security to a customer. Nothing in this article determines the capacity in which a person acts for purposes of any other statute or rule to which such person is subject. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purpose:** To define "broker" for purposes of this Article in terms of function in the particular transaction. The term is applicable to the person performing the function. The differentiation under the Se-

curities Exchange Act of 1934 between "broker" and "dealer" is of no significance under this Article. This and similar distinctions are preserved for other purposes by the last sentence of the section.

#### Definitional cross reference:

"Security". Section 8-102.

#### NORTH CAROLINA COMMENT

This definition substantially accords with the definition of the same term in the Uniform Gifts to Minors Act, GS 33-68

(c). Application of the Code definition is limited to article 8 and does not affect any other statute or law applicable to brokers.

**§ 25-8-304. Notice to purchaser of adverse claims.**—(1) A purchaser (including a broker for the seller or buyer but excluding an intermediary bank) of a security is charged with notice of adverse claims if

- (a) the security whether in bearer or registered form has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or
- (b) the security is in bearer form and has on it an unambiguous statement that



it is the property of a person other than the transferor. The mere writing of a name on a security is not such a statement.

(2) The fact that the purchaser (including a broker for the seller or buyer) has notice that the security is held for a third person or is registered in the name of or indorsed by a fiduciary does not create a duty of inquiry into the rightfulness of the transfer or constitute notice of adverse claims. If, however, the purchaser (excluding an intermediary bank) has knowledge that the proceeds are being used or that the transaction is for the individual benefit of the fiduciary or otherwise in breach of duty, the purchaser is charged with notice of adverse claims. (1899, c. 733, ss. 37, 56; Rev., ss. 2186, 2205; C. S., ss. 3018, 3037; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 37, 56, Uniform Negotiable Instruments Law.

**Changes:** Statement of certain special circumstances in which a purchaser other than an intermediary bank (Section 4—105) is charged as a matter of law with notice of adverse claims.

##### Purposes of changes:

1. Section 8—302 defines “bona fide purchaser” in terms of three distinct elements, “value”, “good faith”, and lack of “notice of any adverse claim”. This section deals only with notice and presents three specific situations in which a purchaser is charged with notice of adverse claims as a matter of law. The listing is not exhaustive and does not exclude other situations in which the trier of the facts may determine that similar notice has been given. For example, receipt of notification that the particular security has been lost or stolen raises the question of notice “forgotten” in good faith. *Kentucky Rock Asphalt v. Mazza’s Admr.*, 264 Ky. 158, 94 S.W.2d 316 (1936); *Graham v. White-Phillips Co.*, 296 U.S. 27, 56 S.Ct. 21, 80 L.Ed. 20, 102 A.L.R. 24 (1935) but cf., *First National Bank of Oedessa v. Fazzari*, 10 N.Y.2d 394, 179 N.E.2d 493 (1961). Also suspicious characteristics of the transaction may give a purchaser (particularly a commercially sophisticated purchaser such as a broker) “reason to know”. *U. S. F. & G. Co. v. Goetz*, 285 N.Y. 74, 32 N.E.2d 798 (1941); *Morris v. Muir*, 111 Misc. 739, 180 N.Y.S. 913 (1920)

2 Subsection (1) (a) refers to situations where a security indorsed “for collection” or “for surrender” is being offered for transfer and follows in effect Section 37 of the Negotiable Instruments Law, which provides that subsequent indorsees acquire only the title of the first indorsee under a restrictive indorsement.

3. In subsection (2) some situations involving purchase from one described or identifiable as a fiduciary are explicitly provided for, again imposing an objective standard, while leaving the door open to

other circumstances which may constitute notice of adverse claims. Mere notice of the existence of the fiduciary relation is not enough in itself to prevent bona fide purchase, and the purchaser is free to take the security on the assumption that the fiduciary is acting properly. The fact that the security may be transferred to the individual account of the fiduciary or that the proceeds of the transaction are paid into that account in cash would not be sufficient to charge the purchaser with notice of potential breach of fiduciary obligation but as in *State Bank of Binghamton v. Bache*, 162 Misc. 128, 293 N.Y.S. 667 (1937) knowledge that the proceeds are being applied to the personal indebtedness of the fiduciary will charge the purchaser with such notice.

4. The notice here involved is to purchasers. A broker acting as such (Section 8—303) is treated in this section as a purchaser though he may not be a purchaser under the definitions of that term (Section 1—201(33)). On the other hand, a bank, stockbroker or other intermediary who, in the particular transaction acts purely in that capacity is not a purchaser. Cf. subsections (3) and (4) of Section 8—306 and Comments 3 and 4 to that Section. The notice to the issuer is covered by Part 4 of this Article. Subsection (2) follows the policy of Section 4 of the Uniform Fiduciaries Act and of Section 3—304(2) with respect to commercial paper. Compare Section 7(a) of the Uniform Act for Simplification of Fiduciary Security Transfers.

The fact that the broker is expressly mentioned in this section carries no negative implication in other sections where merely the word “purchaser” is used. An issuer is not a purchaser. His duty of inquiry is limited and spelled out in Part 4.

##### Cross references:

Point 4: Part 4 of this Article.

See Sections 8—104, 8—302, 8—305 and 8—308.

**Definitional cross references:**

"Adverse claim". Section 8—301.

"Bearer form". Section 8—102.

"Broker". Section 8—303.

"Intermediary bank". Section 4—105.

"Notice". Section 1—201.

"Notification". Section 1—201

"Person". Section 1—201.

"Purchaser". Section 1—201.

"Registered form". Section 8—102.

"Security". Section 8—102.

"Writing". Section 1—201.

**NORTH CAROLINA COMMENT**

GS 25-8-304 declares three special circumstances when purchasers are charged with notice of adverse claims as a matter of law, but it is not exhaustive, so that as a matter of fact other circumstances may also constitute notice. (1) Notice of adverse claims is automatically given if the security is indorsed "for collection" (e.g., a redeemable bond or share of preferred stock which has been redeemed and sent forward to collect the redemption price) or "for surrender" (e.g., a convertible bond which the holder has elected to convert into some other security and sends forward for exchange). Accord, *NIL*, GS 25-43. (2) Notice is imputed if a bearer-form security unambiguously identifies its owner. (3) Notice is given if a purchaser from a fiduciary has "knowledge" (see GS 25-1-201 (25)) that the transaction is for the fiduciary's personal benefit or otherwise in breach of trust. This accords with North Carolina case law. See *Exum v. Bowden*, 39 N.C. (4 Ired. Eq.) 281 (1846) (dictum). However, the mere fact that a

purchaser knows the security is held for a third person or is registered in a fiduciary name does not put the purchaser on notice as to the propriety of the transfer or as to adverse claims. This accords with the rule of the Uniform Act for Simplification of Fiduciary Security Transfers, GS 32-30 (a), that "no person who participates in the acquisition, disposition, assignment or transfer of a security by or to a fiduciary" is liable "for participation in any breach of fiduciary duty by reason of failure to inquire" as to the rightfulness of the transfer, absent actual knowledge. To the extent that the Uniform Fiduciaries Act, GS 32-3 and 32-4, had not done so, the Simplification Act provision overruled early North Carolina holdings such as *Exum v. Bowden*, 39 N.C. (4 Ired. Eq.) 281 (1846) (bond payable to A as guardian of B is of itself notice of B's interest). Although the Simplification Act provision is limited to registered-form securities, GS 25-8-304 (2) also covers bearer-form securities.

**§ 25-8-305. Staleness as notice of adverse claims.**—An act or event which creates a right to immediate performance of the principal obligation evidenced by the security or which sets a date on or after which the security is to be presented or surrendered for redemption or exchange does not of itself constitute any notice of adverse claims except in the case of a purchase.

(a) after one year from any date set for such presentment or surrender for redemption or exchange; or

(b) after six months from any date set for payment of money against presentation or surrender of the security if funds are available for payment on that date. (1899, c. 733, ss. 52, 53; Rev., ss. 2201, 2202; C. S., ss. 3033, 3034; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 52(2), 53, Uniform Negotiable Instruments Law.

**Changes:** Under given circumstances there may now be a bona fide purchaser of a matured instrument.

**Purposes of changes:**

1. In the case of adverse claims the fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods but the maturity of the security does not operate automatically to affect holders' rights. The periods of time here stated are shorter than those appearing in the provisions of this Article on staleness as no-

tice of defects or defenses (Section 8—203) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in his security rather than transfer it at such a time.

Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded.

2. The owner is provided with a means of protecting himself while his security is being sent in for redemption or exchange. He may endorse it "for collection" or for "surrender," and this constitutes notice of his claims (Section 8—304). The present section does not come into operation unless the time period here stated has elapsed.

3. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this section, although under some circumstances they may give the purchaser "reason to know" of claims of ownership.

Georgia Granite R. Co. v. Miller, 144 Ga. 665, 87 S.E. 897 (1916).

**Cross references:**

Point 1: Section 8—203.

Point 2: Section 8—304.

See Section 8—103.

**Definitional cross references:**

"Adverse claim". Section 8—301.

"Money". Section 1—201.

"Notice". Section 1—201.

"Purchase". Section 1—201.

"Right". Section 1—201.

"Security". Section 8—102.

**NORTH CAROLINA COMMENT**

GS 25-8-305, like GS 25-8-203, overrules the requirement of the NIL, that one acquiring an overdue security can never be a holder in due course. See North Carolina Comment to GS 25-8-203. Under GS

25-8-305, a bona fide purchaser acquiring an overdue security within specified time limits may nevertheless extinguish adverse claims to the security.

**§ 25-8-306. Warranties on presentment and transfer.**—(1) A person who presents a security for registration of transfer or for payment or exchange warrants to the issuer that he is entitled to the registration, payment or exchange. But a purchaser for value without notice of adverse claims who receives a new, reissued or re-registered security on registration of transfer warrants only that he has no knowledge of any unauthorized signature (§ 25-8-311) in a necessary indorsement.

(2) A person by transferring a security to a purchaser for value warrants only that

(a) his transfer is effective and rightful; and

(b) the security is genuine and has not been materially altered; and

(c) he knows no fact which might impair the validity of the security.

(3) Where a security is delivered by an intermediary known to be entrusted with delivery of the security on behalf of another or with collection of a draft or other claim against such delivery, the intermediary by such delivery warrants only his own good faith and authority even though he has purchased or made advances against the claim to be collected against the delivery.

(4) A pledgee or other holder for security who redelivers the security received, or after payment and on order of the debtor delivers that security to a third person makes only the warranties of an intermediary under subsection (3).

(5) A broker gives to his customer and to the issuer and a purchaser the warranties provided in this section and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of his customer. (1899, c. 733, ss. 65 to 67, 69; Rev., ss. 2214 to 2216, 2218; C. S., ss. 3046 to 3048, 3050; 1941, c. 353, ss. 11, 12; G. S., ss. 55-91, 55-92; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Sections 65, 66, 67, 69, Uniform Negotiable Instruments Law; Sections 11, 12, Uniform Stock Transfer Act.

**Changes:** Rephrased, and warranties extended under appropriate circumstances to the issuer.

**Purposes of changes:**

1. The warranties here stated have been

recognized by the prevailing case law as well as by the prior Acts cited. See Boston Towboat Co. v. Medford Nat. Bank, 232 Mass. 38, 121 N. E. 491 (1919); Burtch v. Child, Hulswit & Co., 207 Mich. 205, 174 N.W. 170 (1919). Usual estoppel principles apply where the purchaser has knowledge of the defect and these warranties will not be effective in such a case. In addition, under Section 1—102(3)



these provisions apply only "unless otherwise agreed" and the parties are free to enter into any express agreement they desire where both are aware of possible defects.

2. The second sentence of subsection (1) limits the warranties made by the presenter of a security who is a purchaser for value without notice of adverse claims and who receives a new, re-issued or re-registered security, in accordance with the basic change in the law made by this Act, protecting such a person against a claim based on the forgery of an indorsement. (Section 8—311 and Comment, Section 8—405).

3. Subsections (3) and (4) are designed to eliminate all substantive warranties in the case of deliveries by intermediaries and pledgees. Such parties deal primarily with the draft or other claim and, having no access to direct knowledge about the security, they cannot be held to warrant its genuineness or validity.

Further, following *Appenzellar v. McCall*, 150 Misc. 897, 270 N.Y.S. 748 (1934), although the so-called "stock-broker" normally functions as a broker (see definition of "broker", Section 8—303) and on a few occasions another institution such as a

bank may function as a broker, e. g. for a standard broker's commission or similar compensation, nevertheless both the so-called "stock-broker" and the bank can qualify for the protection given by subsections (3) and (4) to an "intermediary" where in the particular transaction it does not function as a broker, e. g. delivering securities on a customer's instructions, either without charge or for a nominal handling charge.

4. In those cases where the so-called "stock-broker" or another person genuinely acts as such (Section 8—303) the warranties, rights and privileges of the broker are spelled out in subsection (5).

#### Cross references:

See Sections 1—102(3), 8—103, 8—301, 8—311 and 8—405.

#### Definitional cross references:

"Broker". Section 8—303.  
 "Delivery". Section 1—201.  
 "Genuine". Section 1—201.  
 "Good faith". Section 1—201.  
 "Person". Section 1—201.  
 "Purchase". Section 1—201.  
 "Purchaser". Section 1—201.  
 "Security". Section 8—102.  
 "Value". Section 1—201.

### NORTH CAROLINA COMMENT

The warranty under GS 25-8-306 (1) of one presenting a security for registration of transfer or for payment or exchange has no counterpart in prior North Carolina statutes. Since North Carolina cases have often held the issuer liable for registering a wrongful transfer, see North Carolina Comment to GS 25-8-401, it is probable that North Carolina would have followed the established rule that the issuer would then have a right over against the person presenting the security for registration of transfer. The warranties under GS 25-8-306 (2) are identical in substance to the warranties of one transferring shares of stock under the Uniform Stock Transfer Act, GS 55-85, or of one negotiating a bond by delivery or qualified indorsement under the NIL, GS 25-71. Unlike the unqualified indorser under the NIL, GS 25-72, the transferor of an in-

vestment security does not warrant that the instrument is "valid or subsisting," but only his ignorance of facts which might impair the validity of the security (GS 25-8-306 (2) (c)), nor does he warrant that the security will be paid (see GS 25-8-308 (4)). Thus, the effect of GS 25-8-306 (2) is to change prior law relating to transfer of negotiable bonds in favor of a single rule for all investment securities derived from the Uniform Stock Transfer Act, GS 25-85.

The warranties of a pledgee (GS 25-8-306 (4)) and of an intermediary (GS 25-8-306 (3)) are substantially the same in result as the pledgee's warranty under the Stock Transfer Act, GS 55-86. The broker's warranty under GS 25-8-305 (5) is without counterpart in prior North Carolina law.

**§ 25-8-307. Effect of delivery without indorsement; right to compel indorsement.**—Where a security in registered form has been delivered to a purchaser without a necessary indorsement he may become a bona fide purchaser only as of the time the indorsement is supplied, but against the transferor the transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied. (1899, c. 733, s. 49; Rev., s. 2198; C. S., s. 3030; 1941, c. 353, s. 9; G. S., s. 55-89; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 49, Uniform Negotiable Instruments Law; Section 9, Uniform Stock Transfer Act.

**Changes:** Stock Transfer Act rule altered, as between the parties transfer now complete upon delivery of security.

**Purposes of changes:**

1. As between the parties the transfer is made complete upon delivery but the transferee cannot become a bona fide purchaser of the security until indorsement is made. The indorsement does not operate retroactively and such notice may intervene between delivery and indorsement as will prevent the transferee from becoming a bona fide purchaser. This Article rejects such cases as *Bethea v. Floyd*, 177 S.C. 521, 181 S.E. 721 (1935), certiorari denied 296 U.S. 622, 56 S.Ct. 143, 80 L.Ed. 442, holding that the indorsement of a note delivered prior to maturity but indorsed thereafter took effect as of the date of delivery to permit the purchaser to become a holder in due course. Although a purchaser taking without a necessary indorsement may be subject to claims of ownership, any issuer's defense of which he had no notice at the time of delivery will be cut off since the provisions of this Article pro-

tect all purchasers for value without notice (Section 8—202).

2. The transferee's right to compel an indorsement where a security has been delivered with intent to transfer is recognized in the case law and the Article of this Act on Documents of Title. See *Coates v. Guaranty Bank & Trust Co.*, 170 La. 871, 129 So. 513 (1930), and Section 7—506 of this Act.

3. A proper indorsement is one of the requisites of transfer which a purchaser has a right to obtain (Section 8—316). A purchaser may not only compel an indorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the demand for an indorsement.

**Cross references:**

Point 1: Section 8—202.

Point 2: Section 7—506.

Point 3: Section 8—316.

See Sections 8—302, 8—308 and 8—309.

**Definitional cross references:**

"Bona fide purchaser". Section 8—302.

"Delivery". Section 1—201.

"Purchaser". Section 1—201.

"Registered form". Section 8—102.

"Right". Section 1—201.

"Security". Section 8—102.

## NORTH CAROLINA COMMENT

Under the Uniform Stock Transfer Act, GS 55-83, delivery of a stock certificate did not effect a complete transfer, even between the parties, until the stock certificate was indorsed. GS 25-8-307 makes delivery of a registered-form security a sufficient transfer between the parties. However, delivery of itself gives the transferee only the rights of the transferor, GS 25-8-301 (1), and the transferee can be-

come a bona fide purchaser only as of the date indorsement is given. Although GS 25-8-307 thus alters the rule of the Stock Transfer Act, it adopts for all investment securities the rule of the NIL, GS 25-55, which applied only to bonds. As under prior law, the transferee of a registered-form investment security has an enforceable right to obtain the needed indorsement.

**§ 25-8-308. Indorsement, how made; special indorsement; indorser not a guarantor; partial assignment.**—(1) An indorsement of a security in registered form is made when an appropriate person signs on it or on a separate document an assignment or transfer of the security or a power to assign or transfer it or when the signature of such person is written without more upon the back of the security.

(2) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies the person to whom the security is to be transferred, or who has power to transfer it. A holder may convert a blank indorsement into a special indorsement.

(3) "An appropriate person" in subsection (1) means

(a) the person specified by the security or by special indorsement to be entitled to the security; or

(b) where the person so specified is described as a fiduciary but is no longer serving in the described capacity,—either that person or his successor; or

(c) where the security or indorsement so specifies more than one person as fiduciaries and one or more are no longer serving in the described capacity,—the

remaining fiduciary or fiduciaries, whether or not a successor has been appointed or qualified; or

(d) where the person so specified is an individual and is without capacity to act by virtue of death, incompetence, infancy or otherwise,—his executor, administrator, guardian or like fiduciary; or

(e) where the security or indorsement so specifies more than one person as tenants by the entirety or with right of survivorship and by reason of death all cannot sign,—the survivor or survivors; or

(f) a person having power to sign under applicable law or controlling instrument; or

(g) to the extent that any of the foregoing persons may act through an agent,—his authorized agent.

(4) Unless otherwise agreed the indorser by his indorsement assumes no obligation that the security will be honored by the issuer.

(5) An indorsement purporting to be only of part of a security representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(6) Whether the person signing is appropriate is determined as of the date of signing and an indorsement by such a person does not become unauthorized for the purposes of this article by virtue of any subsequent change of circumstances.

(7) Failure of a fiduciary to comply with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer, does not render his indorsement unauthorized for the purposes of this article. (1899, c. 733, ss. 22, 31 to 37, 64, 69; Rev., ss. 2179 to 2186, 2213, 2218; C. S., ss. 3011 to 3018, 3045, 3050; 1941, c. 353, s. 20; G. S., s. 55-100; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 31 through 37, 64 through 69, Uniform Negotiable Instruments Law; Section 20, Uniform Stock Transfer Act.

**Changes:** Rephrased and expanded; liability of indorser for issuer's obligations negated.

##### Purposes of changes:

1. The simplified method of indorsement of securities set forth in the Uniform Stock Transfer Act is here continued. The indorser of a security is relieved from liability insofar as honor of the instrument by the issuer is concerned. In view of the nature of investment securities and the circumstances under which they are normally transferred an indorser cannot be held to warrant as to the issuer's actions. As a transferor he, of course, remains liable for breach of the warranties set forth in this Article (Section 8—306).

2. Although more than one special indorsement on a given security is here made possible the desire for dividends or interest, as the case may be, should operate to bring the security home for registration of transfer within a reasonable period of time. The usual form of assignment which appears on the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If

it is not filled up at all but merely signed, the indorsement is in blank; if filled up either as an assignment or as a power of attorney to transfer, the indorsement is special.

3. As under the Uniform Stock Transfer Act, indorsement is one of two distinct steps necessary to a transfer, the other step being delivery of the security (Sections 8—301, 8—302, 8—309). Therefore, subsection (6) of this section makes the indorsements speak as of the date of signing. Section 8—312 on guaranty of signature and Section 8—402 on assurance that indorsements are effective apply the same reasoning. Thus, the signatures on a security indorsed by A during his lifetime or on behalf of X corporation by Y as president during his incumbency do not become "unauthorized" (Section 8—311) because A dies or Y is replaced as president by Z. Authority to deliver and thus to complete the transfer is not covered by this section. Subsection (7) supplements Section 8—403(3) (b) by making it clear that certain matters go to rightfulness of the transfer rather than to the validity of the indorsement. An example is the failure of a duly appointed guardian to obtain a required court approval of the transfer. Such a guardian is an "appropriate person" under subsection (3) (d) of this section, and his



indorsement may be effective even though e. g., a required court order is not obtained.

4. Subsection (3) defines, in paragraphs (b) through (g), the various types of situations in which the signatures of persons other than the registered owner or special indorsee will be appropriate. The paragraphs are not mutually exclusive; for example, the same security may be effectively indorsed either by the registered owner under (a) or by his agent under (g). Paragraph (b) is made explicitly alternative to make it clear that there is no conflict with subsection (3) (a) of Section 8—403, permitting the issuer to rely on the continued power of a fiduciary to act where he is the registered owner and the issuer has not received written notice to the contrary. Similar protection is given to other persons dealing with the security. See also the Comment to Section 8—404.

Paragraphs (f) and (g) in particular are comprehensive. For example, where a "small estate statute" permits a widow to transfer a decedent's securities without administration proceedings, she would be "a person having power to sign under applicable law". Similarly, in the usual partnership case, the signature of a partner would be that of "a person having power to sign under . . . [a] . . . controlling instrument".

#### NORTH CAROLINA COMMENT

GS 25-8-308 states uniform rules for indorsement of all securities in registered form; it is inapplicable to bearer-form securities which pass by delivery alone. Except as noted in the next two paragraphs, GS 25-8-308 is generally consistent with prior provisions of the North Carolina NIL and the Uniform Stock Transfer Act, but it rephrases and expands these provisions.

GS 25-8-308 (4) reverses the NIL rule that an unqualified indorser engages to pay the instrument on dishonor, GS 25-72, by providing that, unless otherwise agreed, the indorser assumes no such liability. This is a desirable change which reflects the view of the investment community that indorsement of a bond is intended only to transfer the property interest but not to underwrite the issuer's performance of the bond obligation.

Indorsement by "an appropriate person" is included in the scope of the guarantee of signature (Section 8—312). It is prerequisite to the issuer's duty to register a transfer (Section 8—401) and to his exoneration from liability for improper registration (Section 8—404).

5. Subsection (5) recognizes, in contradistinction to the rule under the Uniform Negotiable Instruments Law, the validity of a "partial" indorsement of a security, e. g., as to fifty shares of the one hundred represented by a single certificate. The rights of a transferee under a partial indorsement to the status of a bona fide purchaser are left to the case law.

#### Cross references:

Point 1: Section 8—306.

Point 3: Sections 8—301, 8—302, 8—307, 8—309 and 8—312.

Point 4: Section 8—312 and Part 4 of this Article.

#### Definitional cross references:

"Bearer". Section 1—201.

"Delivery". Section 1—201.

"Holder". Section 1—201.

"Honor". Section 1—201.

"Issuer". Section 8—201.

"Person". Section 1—201.

"Registered form". Section 8—102.

"Security". Section 8—102.

"Sign". Section 1—201.

"Written". Section 1—201.

**§ 25-8-309. Effect of indorsement without delivery.**—An indorsement of a security whether special or in blank does not constitute a transfer until delivery of the security on which it appears or if the indorsement is on a separate document until delivery of both the document and the security. (1899, c. 733, s. 30; Rev., s. 2178; C. S., s. 3010; 1941, c. 353, ss. 1, 10; G. S., ss. 55-81, 55-90; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 30, Uniform Negotiable Instruments Law; Sections 1, 10, Uniform Stock Transfer Act.

**Changes:** Rephrased; provisions of Stock Transfer Act as to effect of attempted transfer without delivery omitted.

**Purposes of changes:**

1. There must be a voluntary parting with control in order to effect a valid transfer of an investment security as between the parties. *Levey v. Nason*, 279 Mass. 268, 181 N.E. 193 (1932), and *National Surety Co. v. Indemnity Insurance Co. of North America*, 237 App.Div. 485, 261 N.Y.S. 605 (1933).

2. The provision in Section 10 of the Uniform Stock Transfer Act that an attempted transfer without delivery amounts

to a promise to transfer is here omitted. Even under the prior Act the effect of such a promise was left to the applicable law of contracts and this Article by making no reference to such situations intends to achieve a similar result. There is no counterpart in the case of delivery to Section 8—307 on right to compel indorsement, such as is envisaged in *Johnson v. Johnson*, 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate.

**Cross references:**

Point 2: Section 8—307.

See Sections 8—202(4) and 8—313.

**Definitional cross references:**

"Delivery". Section 1—201.

"Security". Section 8—102.

## NORTH CAROLINA COMMENT

This section is consistent with established North Carolina law making delivery an indispensable requisite to transfer of a security. Uniform Stock Transfer Act, GS 55-75. See *Scottish Bank v. Atkinson*, 245 N.C. 563, 96 S.E.2d 837 (1957), which indicates that delivery coupled with indorsement vests the transferee with the full title to the shares notwithstanding by-law requirements that the shares must be transferred of record, and a contract provision requiring a third party's prior consent to the transfer. See also *Castelloe v.*

*Jenkins*, 186 N.C. 166, 119 S.E. 202 (1923). GS 25-8-309 deletes as unnecessary the Stock Transfer Act provision that an attempted transfer without delivery of the security amounts to a promise to transfer, and to that extent it changes prior law, see GS 55-84. GS 25-8-309 would not preclude the method of stock transfer employed in *Jones v. Waldroup*, 217 N.C. 178, 7 S.E.2d 366 (1940) (transfer of shares on the corporation's books followed by delivery of the stock certificates).

**§ 25-8-310. Indorsement of security in bearer form.**—An indorsement of a security in bearer form may give notice of adverse claims (§ 25-8-304) but does not otherwise affect any right to registration the holder may possess. (1899, c. 733, s. 40; Rev., s. 2189; C. S., s. 3021; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 40, Uniform Negotiable Instruments Law.

**Changes:** Qualification of special indorser's liability omitted.

**Purposes of changes:**

1. The concept of indorsement applies only to registered securities and a purported indorsement of bearer paper is normally of no effect.

An indorsement "for collection", "for surrender" or the like, charges a purchaser with notice of adverse claims (Section 8—304(1) (a)) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered in his name.

2. The provisions of Section 40 of the Negotiable Instruments Law as to the liability of special indorsers of bearer instruments have no applicability here since this Article negates the liability of indorsers as such (Section 8—308).

**Cross references:**

See Sections 8—304 and 8—308.

**Definitional cross references:**

"Bearer form". Section 1—201.

"Holder". Section 1—201.

"Notice". Section 1—201.

"Right". Section 1—201.

"Security". Section 8—102.

## NORTH CAROLINA COMMENT

Since bearer-form securities are transferred solely by delivery, an indorsement

on such a security neither helps nor hinders its transfer, nor does it preclude

further transfer by delivery alone. GS 25-8-310 thus applies to all investment securities the rule of the NIL, GS 25-46. Thus, GS 25-8-310, for reasons peculiar to the nature of investment securities, adopts a rule different from that applicable to commercial paper where specially indorsed bearer paper may subsequently be nego-

tiated only by indorsement, and not by delivery. See GS 25-3-204 (1). Even though an indorsement has no effect on the transfer of a bearer-form instrument, an indorsement "for collection" or "for surrender" or the like may, under GS 25-8-304, give notice to the purchaser of adverse claims.

**§ 25-8-311. Effect of unauthorized indorsement.**—Unless the owner has ratified an unauthorized indorsement or is otherwise precluded from asserting its ineffectiveness

(a) he may assert its ineffectiveness against the issuer or any purchaser other than a purchaser for value and without notice of adverse claims who has in good faith received a new, reissued or re-registered security on registration of transfer; and

(b) an issuer who registers the transfer of a security upon the unauthorized indorsement is subject to liability for improper registration (§ 25-8-404). (1899, c. 733, s. 23; Rev., s. 2171; C. S., s. 3003; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 23, Uniform Negotiable Instruments Law.

**Changes:** Modification of rule as to the ineffectiveness of forged signatures where a bona fide purchaser has received a new, reissued or re-registered security on registration of transfer.

##### Purposes of changes:

1. Since the bulk of present day security purchases is made through brokers, the purchaser who normally receives and sees only a certificate registered in his own name cannot realistically be held to have notice of or to have relied upon a forged or unauthorized indorsement on the original security transferred. A bona fide purchaser holding a new, re-issued or re-registered certificate is therefore protected. Compare *Telegraph Co. v. Davenport*, 97 U.S. 369, 24 L.Ed. 1047 (1878). That line of cases which has refused to apply this rule where the new security is still in the hands of the party to whom it was issued is expressly rejected. See *Weniger v. Success Mining Co.*, 227 F. 548 (C.C.A.Utah 1915); *Hambleton v. Central Ohio R. R. Co.*, 44 Md. 551 (1876).

2. The original owner of a security which has been transferred on the basis of a forged indorsement is protected by the issuer's liability for wrongful registration of transfer (Section 8-404). The issuer's duty to issue a similar security to the

owner unless an overissue would result is made explicit in Part 4 of this Article as is his obligation to purchase available securities on the open market for delivery to the owner where such overissue is involved (see Section 8-104). Compare *Prince v. Childs Co.*, 23 F.2d 605 (1928); *West v. Tintic Standard Mining Co.*, 71 Utah 158, 263 P. 490, 56 A.L.R. 1190 (1928). The issuer's recourse is against the forger and the guarantor of the latter's signature, if any, but where the issuer has a right to require a guarantee of signature, a bona fide purchaser of the forged security presenting the security to the issuer should not be held liable on any implied warranty of title theory unless he knew of the forgery (Section 8-306).

3. A bond which has been registered as to principal and subsequently returned to bearer form is, at the point, a "new security" within the meaning of this Section.

##### Cross references:

Point 2: Sections 8-104, 8-306(1), 8-312, and Part 4 of this Article.

##### Definitional cross references:

"Good faith". Section 1-201.

"Issuer". Section 8-201.

"Notice". Section 1-201.

"Purchaser". Section 1-201.

"Security". Section 8-102.

"Value". Section 1-201.

#### NORTH CAROLINA COMMENT

Under GS 25-1-201 (43), an indorsement is "unauthorized" if made without "actual, implied, or apparent authority" or if it is a forgery. Under the NIL, GS 25-28, a

forged or unauthorized signature was "wholly inoperative" absent estoppel. The general rule under GS 25-8-311 is the same: Transfer on an unauthorized in-



indorsement is ineffective to pass title even to a bona fide purchaser. However, GS 25-8-311's recognition of a limited exception changes prior law. A bona fide purchaser for value may retain the security, as against the true owner, if the purchaser has in good faith presented the security for registration of transfer and has thereafter received a new security from the issuer or transfer agent. If the purchaser has not obtained a new security, the claim of the true owner prevails, unless

he is estopped or has ratified the unauthorized signature. See *Yarbrough v. Banking Loan & Trust Co.*, 142 N.C. 377, 55 S.E. 296 (1906), indicating that a forgery might be ratified in North Carolina. In all events, the issuer who registered transfer on an unauthorized indorsement remains absolutely liable to the true owner, GS 25-8-311 (b) and 25-8-404, but has a right over against the guarantor of the signature, see GS 25-8-313 (1).

**§ 25-8-312. Effect of guaranteeing signature or indorsement. —**

(1) Any person guaranteeing a signature of an indorser of a security warrants that at the time of signing

- (a) the signature was genuine; and
- (b) the signer was an appropriate person to indorse (§ 25-8-308); and
- (c) the signer had legal capacity to sign.

But the guarantor does not otherwise warrant the rightfulness of the particular transfer.

(2) Any person may guarantee an indorsement of a security and by so doing warrants not only the signature (subsection 1) but also the rightfulness of the particular transfer in all respects. But no issuer may require a guarantee of indorsement as a condition to registration of transfer.

(3) The foregoing warranties are made to any person taking or dealing with the security in reliance on the guarantee and the guarantor is liable to such person for any loss resulting from breach of the warranties. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:**  
None.

**Purposes:**

1. The commonly accepted liability of the signature guarantor, which includes a warranty of the authority of the signer to sign for the holder as well as of the capacity of the signer to sign, is here made express so that issuers and their agents may have a clear understanding of the extent to which they may rely upon such guarantees. See *The Jennie Clarkson Home for Children v. Missouri, K. & T. R. Co.*, 182 N. Y. 47, 74 N.E. 571, 70 A.L.R. 787 (1905); *New York Stock Exchange Rules for Delivery*, Rule 198; *New York Curb Exchange Rule S.R.-50*; Rules 43 and 155 of the *New York Stock Transfer Association*.

2. Consistently with the coordinate provisions of Sections 8—308, 8—401 and 8—404, this Section recites the warranty of the guarantor that the signature is that of a person who “at the time of signing” was “an appropriate person” to indorse. The postamble to subsection (1) specifically negates a warranty as to the rightfulness of a transfer as such. Thus the signature guarantor does not warrant that the delivery was rightful or authorized. See the Comment to Section 8—308.

3. An “indorsement guarantee”, covering also the rightfulness of the proposed transfer, is now made available to those parties who wish to use it. In connection with any request to register a transfer, an issuer may properly require a guarantee of signature by a responsible guarantor (Section 8—402). He may not require a guarantee of indorsement, but the voluntary furnishing of such a guarantee and its acceptance by the issuer may save the time and expense of an inquiry into possible adverse claims (cf. Section 8—403).

4. Subsection (3) is expressly designed to encourage issuers and their agents to rely upon signature guarantees and to avoid needless waste of time and duplication of effort in ascertaining the facts so guaranteed.

**Cross reference:**

Point 1: Section 8—308.

See Part 4 of this Article.

**Definitional cross references:**

“Appropriate person” Section 8—308.

“Holder”. Section 1—201.

“Issuer”. Section 8—201.

“Person”. Section 1—201.

“Security”. Section 8—102.

“Sign”. Section 1—201.

## NORTH CAROLINA COMMENT

GS 25-8-312 gives specific legal sanction to signature and indorsement guarantees, which are in common use in North Carolina and are routinely demanded by issuers before registering transfer of securities. Since GS 25-8-401 (1) expressly authorizes issuers and transfer agents to demand a signature guarantee, there will be no change in North Carolina practice. A signature guarantee warrants the genuineness of the signature and that the signer had legal capacity and was an "appropriate person" to sign under GS 25-8-308. It is thus coterminous with the absolute liability of the issuer registering transfer of a security on an "unauthorized indorsement" (see GS 25-8-311 (b)). A signature guarantor does not warrant that the particular transfer was rightful, e.g., was in accord with the

terms of a trust. This accords with law embodied in the Simplification Act, GS 32-20 (a), which relieves "a person who guarantees the signature of the fiduciary" from liability for participation in a breach of trust, apart from actual knowledge of that fact.

GS 25-8-312 (2) recognizes an indorsement guarantee which does warrant the rightfulness of a transfer as well as the validity of the signature. However, an issuer may not demand such a guarantee as a condition to registering transfer, since the issuer is ordinarily not liable with respect to a merely wrongful transfer (see GS 25-8-404). An indorsement guarantee may be voluntarily given to facilitate the issuer in discharging his limited duty of inquiry under GS 25-8-403.

**§ 25-8-313. When delivery to the purchaser occurs; purchaser's broker as holder.**—(1) Delivery to a purchaser occurs when

- (a) he or a person designated by him acquires possession of a security; or
- (b) his broker acquires possession of a security specially indorsed to or issued in the name of the purchaser; or
- (c) his broker sends him confirmation of the purchase and also by book entry or otherwise identifies a specific security in the broker's possession as belonging to the purchaser; or
- (d) with respect to an identified security to be delivered while still in the possession of a third person when that person acknowledges that he holds for the purchaser; or
- (e) appropriate entries on the books of a clearing corporation are made under § 25-8-320.

(2) The purchaser is the owner of a security held for him by his broker, but is not the holder except as specified in subparagraphs (b), (c) and (e) of subsection (1). Where a security is part of a fungible bulk the purchaser is the owner of a proportionate property interest in the fungible bulk.

(3) Notice of an adverse claim received by the broker or by the purchaser after the broker takes delivery as a holder for value is not effective either as to the broker or as to the purchaser. However, as between the broker and the purchaser the purchaser may demand delivery of an equivalent security as to which no notice of an adverse claim has been received. (1899, c. 733, s. 191; Rev., s. 2340; C. S., s. 2976; 1941, c. 353, s. 22; G. S., s. 55-102; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 191, Uniform Negotiable Instruments Law; Section 22, Uniform Stock Transfer Act.

**Changes:** General modification of prior delivery rules in cases involving brokers.

**Purposes of changes:**

1. Subsection 1(a) states the concept of the prior Acts which contemplated an actual transfer of possession of the original instrument as the essential element of delivery. That concept is here broadened to conform to modern conditions under which the bulk of securities transactions are

handled by brokers and on organized markets. Subsections (b), (c) and (d) apply in the relationship of the buying broker to his customer. That relationship is unique, partaking of various aspects of an agency, bailment, trust and pledge. In *re Rosenbaum Grain Corp.*, 103 F.2d 656 (1939); In *re Ellis' Estate*, 24 Del.Ch. 393, 6 A.2d 602 (1939); *Parsons v. Third National Co.*, 230 Mo.App. 1114, 94 S.W.2d 1057 (1936). The final effect of this relationship and the rights and liabilities of the parties are here stated in terms of the actual practice and understanding in finan-

cial circles. Thus, delivery may be completed while the security is still in the hands of the broker. When the factual situations described in subsections (1) (b), (c) and (d) occur, delivery to the purchaser is complete, and no intervening notice of adverse claims before he takes actual physical possession of the security can divest him of his rights.

2. The provisions of subsection (1) (d) as to delivery by acknowledgment are directed primarily toward margin trading, where the securities are pledged by the broker to secure funds for the remainder of the purchase price not advanced by the customer, but, of course, apply also to any other situation where the security is in the possession of a third party.

3. A single completed sale of a security may involve a transfer of several different instruments, that is, from seller to selling broker, from selling broker to buying broker, from buying broker to purchaser; and a security delivered to a broker in response to a customer's order to buy will not in the normal instance be the same security later delivered by him to the customer. Therefore, despite any bookkeeping entries made by him, the broker is regarded as the holder of any securities which are not specifically identified as belonging to a particular customer.

Subsection (2) recognizes the difference between the status of "holder" which is important for various purposes under Article 8 (subsection (20) of Section 1—201; subsection (2) of Section 8—301; Section 8—302) and that of "owner". The affirmative statement that a purchaser is the "owner" of a security held for him by his broker or constituting part of a fungible bulk provides protection to the customer in the event of the broker's insolvency, to the extent such protection may be provided by State law. See *In re Mills*, 125 App.Div. 730, 110 N.Y.Supp. 314 (1st Dept. 1908).

Subsection (3) provides protection to both broker and customer where notice of an adverse claim is received after the broker takes delivery as a holder for value, but also states the principle that as between the broker and his customer, the latter is entitled to delivery of a "clean" security, i. e. one which is genuine and free of any notice of adverse claim. *Isham v. Post*, 141 N.Y. 100, 35 N.E. 1084, 23 L.R.A. 90 (1894), which permitted a broker acting as agent to deliver to his customer a security as to which a claim

of forgery was made after its receipt by the broker, is rejected. The broker is in the business of handling securities. He is better equipped to clear up any questions of genuineness or adverse claim, and even though acting in whole or in part as agent for his customer is not permitted to pass such problems on to his customer. However if the problem arises because of the customer's own act or omission to act he is estopped to rely on it as a basis for rejecting delivery. Section 1—103.

4. The fact that the broker is viewed as a holder and therefore a person who himself can be viewed as a bona fide purchaser of a security is intended to repeal by implication the cases holding the broker liable for "innocent" conversion where no forgery of a necessary indorsement is involved or may be asserted under the provisions of this Article dealing with the effect of forged indorsement. (Section 8—311). He is viewed as standing on an independent bona fide purchaser basis.

5. Subsection (1) (e) has reference to the prevalent practice of brokers (subject to their varying obligations to their customers depending on the type of account in which the securities are held (Subsection (1) of Section 8—107 and Comment) to treat securities as fungible. That practice has been further emphasized by the introduction of clearing procedures on the organized markets. Section 8—320 equates a transfer or pledge effected by appropriate entries on the books of a clearing corporation to "a delivery of a security in bearer form or duly indorsed in blank (Section 8—301) representing the amount of the obligation or the number of shares or rights transferred or pledged". Normally such transactions are between brokers or banks, and unless both transferor and transferee are in account with the clearing corporation, subsection (1) (e) does not apply.

#### Cross references:

Point 4: Section 8—311.

See Sections 8—104, 8—301, 8—314 and 8—315.

#### Definitional cross references:

"Delivery". Section 1—201.

"Fungible". Section 1—201.

"Holder". Section 1—201.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Purchaser". Section 1—201.

"Security". Section 8—102.

"Send". Section 1—201.



## NORTH CAROLINA COMMENT

GS 25-8-313 (1) states five circumstances when delivery occurs. It is consistent with the definition of "delivery" in the NIL, GS 25-1, and the Uniform Stock Transfer Act, GS 55-96 (a) (2), but is more specific in defining types of constructive delivery widely recognized in the financial community. It takes account of common practices in the securities industry by defining events constituting delivery when securities are held, as often they are, in a broker's street name (GS 25-8-313 (1) (c)), or when securities are traded on margin (GS 25-8-313 (1) (d)), or when securities are transferred through clearing corporations (GS 25-8-313 (1) (e)). Although no North Carolina decisions deal with these situations, their specific recognition by the Code does not appear to conflict with prior law and practice.

GS 25-8-313 (2) makes the purchaser (including a purchaser on margin) the "owner" of securities "held for him by his broker," so that upon the broker's involency the customer's securities are not assets subject to claims of the broker's

creditors. Except for the margin purchaser, the purchaser is not only the owner but also has the rights of a "holder" (see GS 25-1-201 (20)). Thus, one who has acquired shares held by his broker for him in the purchaser's name or in street name may take the rights of a bona fide purchaser (see GS 25-8-301 and 25-8-302).

Under GS 25-8-313 (3), notice of an adverse claim (see GS 25-8-301 (1)) received after delivery to the broker does not preclude bona fide purchaser status. Since such a certificate may still be virtually unmarketable by the purchaser, GS 25-8-313 (3) places the risk of a tainted certificate on the broker and gives the customer a right against the broker to a clean certificate, on the theory that the broker has superior facilities for procuring a clean certificate. See the Reclamation Rules of the New York Stock Exchange, Rules 265-275. GS 25-8-313 (3) thus reverses the rule of *Isham v. Post*, 141 N.Y. 100, 35 N.E. 1084 (1894), relieving the broker of any obligation to furnish the customer with an untainted certificate.

**§ 25-8-314. Duty to deliver, when completed.**—(1) Unless otherwise agreed where a sale of a security is made on an exchange or otherwise through brokers

(a) the selling customer fulfills his duty to deliver when he places such a security in the possession of the selling broker or of a person designated by the broker or if requested causes an acknowledgment to be made to the selling broker that it is held for him; and

(b) the selling broker including a correspondent broker acting for a selling customer fulfills his duty to deliver by placing the security or a like security in the possession of the buying broker or a person designated by him or by effecting clearance of the sale in accordance with the rules of the exchange on which the transaction took place.

(2) Except as otherwise provided in this section and unless otherwise agreed, a transferor's duty to deliver a security under a contract of purchase is not fulfilled until he places the security in form to be negotiated by the purchaser in the possession of the purchaser or of a person designated by him or at the purchaser's request causes an acknowledgment to be made to the purchaser that it is held for him. Unless made on an exchange a sale to a broker purchasing for his own account is within this subsection and not within subsection (1). (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. This section, together with the section on warranties to the purchaser (Section 8—306) and the section on delivery to the purchaser (Section 8—313), states the rights and duties of the parties involved in the transfer of a security from the original transferor to the ultimate purchaser. Particular emphasis has been placed upon

transactions on organized exchanges or through brokers or dealers since they account for the great bulk of security sales. Normally the sale of a security on such an exchange or through brokers involves at least three intermediate transactions, and perhaps more, depending upon the number of correspondent brokers concerned. Rarely does the same security travel through the entire transaction and the duty of each intermediate party in the

chain of transfer must therefore be stated. The increased use of clearing houses is also recognized and a selling broker is specifically permitted to make delivery by clearing the sale through such a clearing agency.

2. Under subsection (2), absent agreement or request, one delivering a security to a purchaser in a transaction not consummated on an exchange or through brokers must make physical delivery. He cannot, for example, just put the security in transit and impose the risk of loss upon the recipient. The last sentence covers the situation where one in business as a broker is, in the particular transaction, his own customer. When he buys or sells for a customer other than himself, whether as

agent or as principal he is a "broker" under this Article (Section 8—303) and the transaction is within subsection (1) of this section.

**Cross references:**

Sections 8—303, 8—306 and 8—313.

**Definitional cross references:**

"Agreed". Section 1—201.

"Agreement". Section 1—201.

"Broker". Section 8—303.

"Contract". Section 1—201.

"Delivery". Section 1—201.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Purchaser". Section 1—201.

"Security". Section 8—102.

"Send". Section 1—201.

### NORTH CAROLINA COMMENT

GS 25-8-314 (2) states when the seller has fulfilled his duty to deliver a security which is being transferred other than through a securities exchange or other facilities of brokers, e.g., from one individual to another, or one bank to another. In general, delivery means physical transfer of possession to the purchaser or his agent; a registered-form security must also be indorsed. Since the risk of loss remains on the seller until the purchaser obtains possession, mailing the security is not of itself a sufficient delivery.

GS 25-8-314 (1) states when the seller has fulfilled his duty to deliver a security transferred through a securities exchange or other brokers' facilities. In general, the

seller's duty is completed when he delivers possession to the selling broker; and the selling broker's duty is consummated when he transfers possession of the security itself (or a like security) to the purchasing broker or his nominee or clears the security through exchange clearing procedures. The implication of GS 25-8-314 (1) is that if the seller has completed his duty of delivery by transfer to the selling broker, the risk of loss thereafter rests on the selling broker.

Since GS 25-8-314 states the common understanding of the investment community, it may be assumed that North Carolina practice is not inconsistent.

**§ 25-8-315. Action against purchaser based upon wrongful transfer.**  
—(1) Any person against whom the transfer of a security is wrongful for any reason, including his incapacity, may against anyone except a bona fide purchaser reclaim possession of the security or obtain possession of any new security evidencing all or part of the same rights or have damages.

(2) If the transfer is wrongful because of an unauthorized indorsement, the owner may also reclaim or obtain possession of the security or new security even from a bona fide purchaser if the ineffectiveness of the purported indorsement can be asserted against him under the provisions of this article on unauthorized indorsements (§ 25-8-311).

(3) The right to obtain or reclaim possession of a security may be specifically enforced and its transfer enjoined and the security impounded pending the litigation. (1941, c. 353, s. 7; G. S., s. 55-87; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 7, Uniform Stock Transfer Act.

**Changes:** Rephrased; statement of rule in case of forged or unauthorized indorsements added.

**Purposes of changes and new matter:**

1. The general rule permitting an owner to reclaim possession of a security wrongfully transferred is here continued. An

exception is made, as in the prior law, in favor of bona fide purchasers. Where the transfer is based upon a forged or unauthorized indorsement the exception operates in favor only of a bona fide purchaser who has received a new security upon registration of transfer. See Section 8—311 and the comments thereto.

2. This section deals only with the

owner's right to reclaim possession of the security and is not intended to exclude any rights he may have to damages for conversion under the case law. But see Section 8—318, which protects innocent brokers and other agents and bailees from liability for conversion.

**Cross references:**

Sections 8—311 and 8—318.

**NORTH CAROLINA COMMENT**

GS 25-8-315 states the circumstances under which the true owner of a security has a right of action against the purchaser, either to reclaim the security, obtain a new security, or have damages. It distinguishes a merely wrongful transfer (GS 25-8-315 (1)) from a transfer on an unauthorized indorsement (GS 25-8-315 (2), referring to GS 25-8-311). GS 25-8-315 (1) substantially accords with the Uniform Stock Transfer Act, GS 55-81, in its protection of a bona fide purchaser where the indorsement is not unauthorized but the transfer is wrongful. Thus, under the

**Definitional cross references:**

"Action". Section 1—201.

"Bona fide purchaser". Section 8—302.

"Person". Section 1—201.

"Right". Section 1—201.

"Security". Section 8—102.

Code provision the bona fide purchaser would prevail although transfer was obtained through fraud or duress, or under a mistake, or in breach of trust. See also *Green v. Forsyth Furniture Lines*, 198 N.C. 104, 150 S.E. 713 (1929) (stock procured by fraud transferred to bona fide purchaser). GS 25-8-315 (2) supplements (but is not inconsistent with) the Stock Transfer Act by stating the limited circumstances in which a purchaser may prevail over a true owner where the indorsement is unauthorized. See North Carolina Comment on GS 25-8-311.

**§ 25-8-316. Purchaser's right to requisites for registration of transfer on books.**—Unless otherwise agreed the transferor must on due demand supply his purchaser with any proof of his authority to transfer or with any other requisite which may be necessary to obtain registration of the transfer of the security but if the transfer is not for value a transferor need not do so unless the purchaser furnishes the necessary expenses. Failure to comply with a demand made within a reasonable time gives the purchaser the right to reject or rescind the transfer. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. The registration of the transfer of a security is a matter of vital importance to a purchaser and he is here provided with the means of obtaining such formal requirements for registration as signature guarantees, proof of authority, transfer tax stamps and the like. In practice, it is the custom for the transferor to register transfer out of his own name and into that of the transferee, or into "street name" before delivery of the security. If he does not do this, he is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer and his duty to do so upon demand within a reasonable time is here stated affirmatively. But if the transfer is not for value the transferee should pay expenses.

2. If the transferor's duty is not performed the transferee may reject or rescind the transfer. He is not bound to do so; he may prefer his action for damages for breach of contract; and if an essential item is peculiarly within the province of the transferor so that he is the only one who can obtain it, the purchaser may specifically enforce his right. Compare Section 8—307.

**Cross reference:**

Section 8—307.

**Definitional cross references:**

"Purchaser". Section 1—201.

"Reasonable time". Section 1—204.

"Right". Section 1—201.

"Security". Section 8—102.

"Value". Section 1—201.

**NORTH CAROLINA COMMENT**

GS 25-8-316 specifically requires the transferor to aid the transferee in registering his securities on the issuer's books.

Since the issuer's duty to register transfer arises only if certain conditions have been met (see GS 25-8-401 (1)), the trans-



feror may be compelled to furnish the necessary indorsements (see GS 25-8-307), to procure a signature guarantee (see GS 25-8-312), and, where necessary, proof of authority to transfer (see GS 25-8-308 (3)), and to furnish the transfer tax stamps. Under prior law the transferor had to furnish necessary indorsements. Uniform Stock Transfer Act, GS 55-83. Since North Carolina decisions held that a bona fide purchaser was entitled to registration of transfer on the issuer's books,

*Green v. Forsyth Furniture Lines*, 198 N.C. 104, 150 S.E. 713 (1929), it seems a fair inference that the purchaser was entitled to other requisites for implementing this right. Under the Code, if the purchaser paid value for the security, the transferor must perform these duties at his own expense; otherwise, the transferee must cover the cost. The transferor's default entitles the purchaser to rescind the transaction or to recover damages.

§ 25-8-317. **Attachment or levy upon security.**—(1) No attachment or levy upon a security or any share or other interest evidenced thereby which is outstanding shall be valid until the security is actually seized by the officer making the attachment or levy but a security which has been surrendered to the issuer may be attached or levied upon at the source.

(2) A creditor whose debtor is the owner of a security shall be entitled to such aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching such security or in satisfying the claim by means thereof as is allowed at law or in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process. (1941, c. 353, ss. 13, 14; G. S., ss. 55-93, 55-94; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 13, 14, Uniform Stock Transfer Act.

**Changes:** Rephrased for clarity.

**Purposes of changes:**

1. In dealing with investment securities the instrument itself is the vital thing and therefore a valid levy cannot be made unless all possibility of the security finding its way into a transferee's hand has been removed. This can be accomplished only when the security has been reduced to possession by a public officer or by the issuer. A holder who has been enjoined can still transfer the security in contempt of court. See *Overlock v. Jerome Portland Copper Mining Co.*, 29 Ariz. 560, 243 P. 400 (1926). Therefore, although injunctive relief is provided in subsection (2) so that creditors may use this method to gain control of the security, the security itself must be reached to constitute a proper levy. The method used in *Hodes v. Hodes*, 176 Or. 102, 155 P.2d 564 (1945), where the Oregon court enjoined the transfer of a security in a safe deposit box in the state of Washington, directing a copy of the writ to be served upon the issuer, although not operative as an effective levy, is a method of reaching the security approved by the section.

2. An attachment filed at the issuer's office against the shares represented by the security on the books is ineffective unless the security itself has been surrendered to the issuer. The case law holdings that priority in time of transfer or attachment governed the validity of the levy are rejected under this Article as under the Stock Transfer Act. See for example, *National Bank of Pacific v. Western Pac. R. Co.*, 157 Cal. 573, 108 P. 676, 27 L.R.A., N.S., 987, 21 Ann.Cas. 1391 (1910).

3. This section deals with the problems of attaching or levying creditors and prevents such persons from securing rights paramount to those of purchasers, who have actual possession of the security. It does not apply in cases where a governmental agency, for reasons of public safety or the like, seeks to confiscate securities. See, for example, the situation in *Silesian American Corp. v. Clark*, 332 U.S. 469, 68 S.Ct. 179, 92 L.Ed. 81 (1947), upon which this section has no bearing.

**Definitional cross references:**

"Creditor". Section 1—201.

"Issuer". Section 8—201.

"Security". Section 8—201.

#### NORTH CAROLINA COMMENT

GS 25-8-317 reflects the extent to which article 8 goes in reducing the security interest to the instrument itself and giving full negotiability to the instrument. Like

the Uniform Stock Transfer Act, GS 55-87, no attachment or levy is effective absent physical seizure of the instrument, or its surrender to the issuer followed by

attachment. Unlike prior North Carolina law embodied in the Stock Transfer Act, an injunction against transfer is not of itself a sufficient attachment, for, as recognized by *Green v. Forsyth Furniture Lines*, 198 N.C. 104, 150 S.E. 713 (1929), the holder still has power to defy the injunction and transfer the security to a

bona fide purchaser, thereby defeating the attachment. However, under both GS 25-8-317 (2) and the Uniform Stock Transfer Act, GS 55-88, injunction and other process may aid one in gaining the indispensable possession of the security itself and thus lay the ground for an attachment effective under GS 25-8-317 (1).

§ 25-8-318. **No conversion by good faith delivery.**—An agent or bailee who in good faith (including observance of reasonable commercial standards if he is in the business of buying, selling or otherwise dealing with securities) has received securities and sold, pledged or delivered them according to the instructions of his principal is not liable for conversion or for participation in breach of fiduciary duty although the principal had no right to dispose of them. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

To negate the liability of agents, including brokers, and of bailees, for innocent conversion or participation in breach of fiduciary duty. *Gruntal v. U. S. Fidelity and Guaranty Co.*, 254 N.Y. 468, 173 N.E. 682 (1930) followed. Compare Section 7

(a) of the Uniform Act for Simplification of Fiduciary Security Transfers.

**Cross reference:**

Section 7—404.

**Definitional cross references:**

"Delivery". Section 1—201.

"Good faith". Section 1—201.

"Security". Section 8—102.

#### NORTH CAROLINA COMMENT

GS 25-8-318 exonerates the good faith agent or bailee from liability for conversion or participation in breach of trust if he disposes of securities on his principal's instructions. This provision accords with the Uniform Act for Simplification of Fiduciary Security Transfers, GS 33-20 (a), which relieves individuals from liability

for participation in breach of trust when they handle securities whose transfer by or to a fiduciary is a breach of trust, and extends the same immunity to transfers other than those of fiduciaries. See also *Whiteford v. Lane*, 190 N.C. 343, 130 S.E. 36 (1925).

§ 25-8-319. **Statute of frauds.**—A contract for the sale of securities is not enforceable by way of action or defense unless

(a) there is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price; or

(b) delivery of the security has been accepted or payment has been made but the contract is enforceable under this provision only to the extent of such delivery or payment; or

(c) within a reasonable time a writing in confirmation of the sale or purchase and sufficient against the sender under paragraph (a) has been received by the party against whom enforcement is sought and he has failed to send written objection to its contents within ten days after its receipt; or

(d) the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract was made for sale of a stated quantity of described securities at a defined or stated price. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29 Charles II).

**Changes:** Completely rephrased.

**Purposes of changes:**

To conform the statute of frauds pro-

visions with regard to securities to the policy of the provisions in the Article on Sales (Article 2) on sale of goods. Requirements for minimum specification of quantity and price consistent with business practice in the securities field are added.

1. What will be sufficient specification will vary with the circumstances. Where the transaction is on an exchange or an over-the-counter market where daily quotations of the security are available "100 shares X. Corp. comm. @ market" should suffice. If there is no readily available standard to interpret "@ market" there is no "defined or stated price."

2. Paragraph (c) is particularly important in the relationship of broker (Section 8-303) and customer. Normally a great volume of such business is done over the telephone. Orders are executed almost immediately and confirmed on the same or the next business day, usually on standard forms which as to the broker

more than meet the minimal requirements of paragraph (a). It is reasonable to require the customer to raise his objection, if any, within ten days after the confirmation has been received (Section 1-201).

**Cross reference:**

See Section 2-201 and Comment thereto.

**Definitional cross references:**

"Action". Section 1-201.

"Delivery". Section 1-201.

"Party". Section 1-201.

"Purchase". Section 1-201.

"Security". Section 8-103.

"Send". Section 1-201.

"Sign". Section 1-201.

"Written" and "writing". Section 1-201.

**NORTH CAROLINA COMMENT**

GS 25-8-319 provides a statute of frauds for sales of all securities, and defines a sufficient writing. Particularly important is the Code's validation of the normal practice of purchasing securities on an oral order followed by a written confirmation which is not thereafter objected to by the customer. GS 25-8-319 (c). Although no general statute of frauds applied to sales of securities, the Business Corpora-

tion Law, GS 55-43 (b), requires all pre-incorporation and post-incorporation stock subscriptions to be "in writing, signed and delivered by the subscriber" in order to be "valid." An early version of the "Blue Sky Law" apparently required contracts for sales of stock to be in writing. See *Seminole Phosphate Co. v. Johnson*, 188 N.C. 419, 124 S.E. 859 (1924).

**§ 25-8-320. Transfer or pledge within a central depository system.—**

**(1) If a security**

(a) is in the custody of a clearing corporation or of a custodian bank or a nominee of either subject to the instructions of the clearing corporation; and

(b) is in bearer form or indorsed in blank by an appropriate person or registered in the name of the clearing corporation or custodian bank or a nominee of either; and

(c) is shown on the account of a transferor or pledgor on the books of the clearing corporation;

then, in addition to other methods, a transfer or pledge of the security or any interest therein may be effected by the making of appropriate entries on the books of the clearing corporation reducing the account of the transferor or pledgor and increasing the account of the transferee or pledgee by the amount of the obligation or the number of shares or rights transferred or pledged.

(2) Under this section entries may be with respect to like securities or interests therein as a part of a fungible bulk and may refer merely to a quantity of a particular security without reference to the name of the registered owner, certificate or bond number or the like and, in appropriate cases, may be on a net basis taking into account other transfers or pledges of the same security.

(3) A transfer or pledge under this section has the effect of a delivery of a security in bearer form or duly indorsed in blank (§ 25-8-301) representing the amount of the obligation or the number of shares or rights transferred or pledged. If a pledge or the creation of a security interest is intended, the making of entries has the effect of a taking of delivery by the pledgee or a secured party (§§ 25-9-304 and 25-9-305). A transferee or pledgee under this section is a holder.

(4) A transfer or pledge under this section does not constitute a registration of transfer under part 4 of this article.

(5) That entries made on the books of the clearing corporation as provided in



subsection (1) are not appropriate does not affect the validity or effect of the entries nor the liabilities or obligations of the clearing corporation to any person adversely affected thereby. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

Consistent with the underlying purposes and policies of this Act "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties"—subsection (2) (b) of Section 1—102—this Section expressly authorizes a newly developing and commercially useful method of transferring or pledging securities on the organized securities markets, particularly among brokers and banks but not necessarily so limited.

The key provision in subsection (3) gives the procedures authorized in subsections (1) and (2) "the effect of a delivery of a security in bearer form or duly indorsed in blank". See subsection (1) (e) of Section 8—313.

Subsection (4) makes clear that trans-

fer or pledge under this Section does not change the registered ownership of the affected security and subsection (5) states the accountability of a clearing corporation to persons adversely affected by entries made on its books which "are not appropriate".

**Cross references:** Sections 1—102(2) (b); 8—301; 8—302; 8—308; 8—313; Part 4 of Article 8; Sections 9—304; 9—305.

**Definitional cross references:**

"Appropriate person". Section 8—308(3).

"Clearing corporation". Section 8—102.

"Custodian bank". Section 8—102.

"Delivery". Sections 1—201(14); 8—313 (1).

"Fungible". Section 1—201 (17).

"Security". Section 8—102.

"Security interest". Section 1—201(37).

"Secured party". Section 9—105(1) (i).

#### NORTH CAROLINA COMMENT

GS 25-8-320, without counterpart in prior North Carolina law, gives specific legal recognition to recently evolved procedures, analogous to bank clearing methods, for transferring securities in the organized markets. Securities are held by the "clearing corporation" (see GS 25-8-102 (2)) or by a "custodian bank" (GS 25-8-102 (4)), either in bearer form or indorsed in blank or registered in the name of the clearing corporation or the custo-

dian bank. Securities may then be transferred or pledged merely upon making book entries reflecting the increase or decrease in the accounts of members of the clearing system. Such entries constitute a delivery of the securities (see GS 25-8-313 (1) (e) and 25-8-320 (3)) to the purchaser, who thus takes the rights of any purchaser (GS 25-8-301 (1)) or becomes a bona fide purchaser (GS 25-8-302).

### PART 4.

#### REGISTRATION.

§ 25-8-401. **Duty of issuer to register transfer.**—(1) Where a security in registered form is presented to the issuer with a request to register transfer, the issuer is under a duty to register the transfer as requested if

(a) the security is indorsed by the appropriate person or persons (§ 25-8-308); and

(b) reasonable assurance is given that those indorsements are genuine and effective (§ 25-8-402); and

(c) the issuer has no duty to inquire into adverse claims or has discharged any such duty (§ 25-8-403); and

(d) any applicable law relating to the collection of taxes has been complied with; and

(e) the transfer is in fact rightful or is to a bona fide purchaser.

(2) Where an issuer is under a duty to register a transfer of a security the issuer is also liable to the person presenting it for registration or his principal for loss resulting from any unreasonable delay in registration or from failure or refusal to register the transfer. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

Prior uniform statutory provision: None.

## Purposes:

1. Section 8—201(3) defines “issuer” as used in this Part 4 as the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like have rights and duties under this Part within the scope of their respective functions, similar to those of the issuer (Section 8—406).

2. There is a substantial and heterogeneous body of case law as to the issuer's duty to register a transfer and as to his liability for improper registration, e. g., on an unauthorized signature (Section 8—311), or where the indorsement is not that of an appropriate person (Section 8—308), and generally under circumstances where the issuer is deemed to have had notice of an adverse claim (Section 8—301) and thus of the possible wrongfulness of the transfer.

In general this section and those which follow it continue the well-settled rules found in the case law as to duty to register and as to liability for improper registration on an unauthorized signature, or where the indorsement is not that of an appropriate person. They clarify the application of those rules in accordance with the fact patterns found in the usual business situations.

In all other areas, the issuer's potential liability for wrongful registration of transfer has been substantially reduced. The rules found in the case law are drastically modified in furtherance of a considered policy to speed up the registration process by narrowing the field in which the issuer historically has first sought to assure itself that it cannot be held to be on notice of an adverse claim, and, failing that assurance, has imposed rigorous requirements of proof that there is no possible impropriety.

3. This section states the basic duty of the issuer to register transfers. It states that a duty exists but only if certain preconditions exist. If any of the preconditions do not exist, there is no duty to register transfer. If the indorsement on a security is a forgery, there is no duty.

If there has not been compliance with applicable tax laws, there is no duty. If the security is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a bona fide purchaser (and the other preconditions exist). Cf. *Kaiser-Frazer Corp. v. Otis & Co.*, 195 F.2d 838 (2d Cir.1952), certiorari denied 73 S.Ct. 89, 344 U.S. 856, 97 L.Ed. 664.

This section does not constitute a mandate that all preconditions must be met before the issuer registers a transfer. Conversely, it is not a prohibition upon transfers when not all the preconditions are met. If it so desires, the issuer can waive the reasonable assurances specified in subparagraph (b). If it has confidence in the responsibility of the persons requesting transfer, it can ignore questions of compliance with tax laws. If it has no notice of or duty to inquire into adverse claims, it can and it should register transfer without inquiry as to the rightfulness of a transfer. This section is not a check list of steps the issuer must take before registering a transfer. Sections 8—402 and 8—403 are the sections dealing with mechanics and Section 8—402 imposes limits on assurances that may be requested. Section 8—401 recognizes the duty to register transfer clearly established by case law but then states limitations on this duty.

By subsection (2) the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

## Cross references:

Point 1: Sections 8—201(3) and 8—406.

Point 2: Sections 8—204, 8—301, 8—308 and 8—311.

## Definitional cross references:

“Adverse claim”. Section 8—301.

“Appropriate person”. Section 8—308.

“Bona fide purchaser”. Section 8—302.

“Indorsement”. Section 8—308.

“Issuer”. Section 8—201(3).

“Person”. Section 1—201.

“Registered form”. Section 8—102.

“Security”. Section 8—102.

## NORTH CAROLINA COMMENT

GS 25-8-401 states for the first time in any uniform statute the duty of the issuer to register transfer of a registered-form security, and the issuer's liability for nonregistration.

(1) *Background*: Prior to specific statutes, North Carolina adhered to the ma-

jority American view, see *Lowry v. Commercial & Farmer's Bank*, 15 Fed. Cases 1040 (No. 8581) (C.C.D. Md. 1848), that the issuer is trustee for all of its shareholders with respect to the transfer of securities, that it owes to shareholders a duty to investigate the rightfulness of

each transfer, and that registering transfer without due inquiry makes the issuer absolutely liable to the "true owner." See *Baker v. Atlantic Coast Line R.R.*, 173 N.C. 365, 92 S.E. 170 (1917); *Cox v. First Nat'l Bank*, 119 N.C. 302, 26 S.E. 22 (1896); *Wooten v. Wilmington & W.R.R.*, 128 N.C. 119, 38 S.E. 298 (1901); *Richardson v. King*, 136 F.2d 849 (4th Cir.), cert. denied, 320 U.S. 777, 64 Sup. Ct. 91, 88 L. Ed. 466 (1943). Under these decisions, the corporation was specifically obligated, at its peril, to determine the rightfulness of any particular transfer by a fiduciary. See especially *Baker v. Atlantic Coast Line R.R.*, 173 N.C. 365, 92 S.E. 170 (1917), stating rules governing particular classes of fiduciaries. This liability of the issuer—to determine rightfulness of a particular transfer—was in addition to the issuer's undoubted liability for registering transfer of shares on a forged or unauthorized indorsement. See, e.g., *Bank of Virginia v. Craig*, 50 Va. (6 Leigh) 399 (1835).

North Carolina has progressively modified the early case-law rule whose effect was to compel the issuer, for its own protection, to seek excessive documentation of security transfers, with the attendant delay and expense. North Carolina's 1923 adoption of the Uniform Fiduciaries Act relieved issuers and transfer agents of any obligation to "inquire whether the fiduciary is committing a breach of his obligation . . . or to see to the performance of the fiduciary obligation" and imposed liability only upon an issuer registering transfer with "actual knowledge" of the breach or otherwise in bad faith. GS 32-4, construed in *Carolina Tel. & Tel. Co. v. Johnson*, 168 F.2d 489 (4th Cir. 1948), to relieve the issuer under the facts of that case for liability for registering transfer of shares by a guardian who neglected to account for the proceeds. But cf. *Richardson v. King*, 136 F.2d 849 (4th Cir.), cert. denied, 320 U.S. 777, 64 Sup. Ct. 91, 88 L. Ed. 466 (1943), holding the issuer liable for registering transfer in breach of trust without mention of the Uniform Fiduciaries Act, although the issuer presumably had "actual knowledge" of the nature of the transfer, 136 F.2d at 859.

The Uniform Act for Simplification of Fiduciary Security Transfers, adopted in 1959, expressly relieved issuers and transfer agents of a general duty to inquire into the fiduciary relationship, authorized issuers to assume without inquiry the rightfulness of each transfer, negated constructive notice from publicly recorded

documents, specified the limited documentation needed for registering a fiduciary security transfer, and expressly exonerated the issuer from any liability for acts conforming to the statutory standards. GS 32-15, 32-16, 32-17 and 32-19.

GS 25-8-401 through 25-8-404 give issuers the same protection on registering any security transfers as the Simplification Act now accords to fiduciary transfers. In thus making universal these rules, it does not depart from North Carolina law embodied in the Uniform Fiduciaries Act and the Simplification Act, except possibly so far as the older case law might apply outside the ambit of fiduciary security transfers.

(2) GS 25-8-401 (1) mandates the issuer to register transfer of any security if certain conditions are met. If these conditions are satisfied, but the transfer is in fact wrongful, the issuer has no duty to register transfer, unless it is to a bona fide purchaser. Accord, *Green v. Forsyth Furniture Lines*, 198 N.C. 104, 150 S.E. 713 (1929) (corporation must issue new certificate to bona fide purchaser even though corporation knew of fraud practiced on the original owner by an intermediate transferor). Since the issuer has no duty to register a wrongful transfer to one who is not a bona fide purchaser, it is privileged to refuse registration under GS 25-8-401 (1). If the issuer knows that a transfer is not "in fact rightful" or that the purchaser is not a BFP, but all other conditions are satisfied, the issuer is under no duty to register transfer, GS 25-8-401 (1) (e), but if it does so, it would appear not to be liable, see GS 25-8-404 (1), unless its act was demonstrably not in "good faith," see GS 25-1-201 (14). Although not mentioned in GS 25-8-401, it is assumed that the presenter surrenders the old certificate, for "a corporation which proceeds to transfer stock 'in the absence of the original certificate' . . . does so 'at its own peril' . . ." *Suskin v. Hodges*, 216 N.C. 333, 4 S.E.2d 891 (1939).

(3) GS 25-8-401 (2) makes the issuer liable to the presenter for failure or refusal to register transfer or for loss from an unreasonable delay in registration. See *Sheppard v. Rockingham Power Co.*, 150 N.C. 776, 64 S.E. 894 (1909) ("a mandamus or mandatory injunction lies to compel a corporation to transfer stock"). GS 25-8-401 (2) would not alter existing procedural requirements. See, e.g., *Griffin & Vose, Inc. v. Non-Metallic Minerals Corp.*, 225 N.C. 434, 35 S.E.2d 247 (1945)



(alleged transferors are necessary parties to transferee's suit to compel corporation to register stock transfer).

(4) Part 4 of article 8 (GS 25-8-401 through 25-8-406) applies not only to is-

suers but also to transfer agents, registrars, or other persons handling security transfers. See GS 25-8-201 (3) and 25-8-406.

**§ 25-8-402. Assurance that indorsements are effective.**—(1) The issuer may require the following assurance that each necessary indorsement (§ 25-8-308) is genuine and effective

(a) in all cases, a guarantee of the signature (subsection (1) of § 25-8-312) of the person indorsing; and

(b) where the indorsement is by an agent, appropriate assurance of authority to sign;

(c) where the indorsement is by a fiduciary, appropriate evidence of appointment or incumbency;

(d) where there is more than one fiduciary, reasonable assurance that all who are required to sign have done so;

(e) where the indorsement is by a person not covered by any of the foregoing, assurance appropriate to the case corresponding as nearly as may be to the foregoing.

(2) A "guarantee of the signature" in subsection (1) means a guarantee signed by or on behalf of a person reasonably believed by the issuer to be responsible. The issuer may adopt standards with respect to responsibility provided such standards are not manifestly unreasonable.

(3) "Appropriate evidence of appointment or incumbency" in subsection (1) means

(a) in the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of that court or an officer thereof and dated within sixty days before the date of presentation for transfer; or

(b) in any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by the issuer to be responsible or, in the absence of such a document or certificate, other evidence reasonably deemed by the issuer to be appropriate. The issuer may adopt standards with respect to such evidence provided such standards are not manifestly unreasonable. The issuer is not charged with notice of the contents of any document obtained pursuant to this paragraph (b) except to the extent that the contents relate directly to the appointment or incumbency.

(4) The issuer may elect to require reasonable assurance beyond that specified in this section but if it does so and for a purpose other than that specified in subsection (3) (b) both requires and obtains a copy of a will, trust, indenture, articles of copartnership, bylaws or other controlling instrument it is charged with notice of all matters contained therein affecting the transfer. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

##### **Purposes:**

1. As noted (See the Comment to Section 8—401) the issuer's absolute liability, stated in the cases, for wrongful registration of transfer where the signature of the indorser is unauthorized (Section 8—311) or is not that of an appropriate person (Section 8—308) is continued. Under the circumstances, the issuer is entitled to require reasonable assurance that all necessary indorsements are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which,

except in the rarest of instances, should be easily furnished. If a demand for further assurance is reasonable under the circumstances, subsection (4) applies.

2. Under subsection (1) (a) the issuer may require in all cases a guarantee of signature (Section 8—312). Under subsection (2) the guarantor must be one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. In this aspect, this section approves the practice of the organized securities markets.

3. Section 8—312(3) gives the issuer

an action over against the guarantor of signature for breach of the warranties stated in that section. Both the indorsement and the guarantee of signature speak as of the "date of signing" or "time of signing." See Sections 8—308(6), 8—312(1). This section, by paragraphs (b) through (e) of subsection (1), permits the issuer to seek confirmation of the effectiveness of the indorsement. The permitted methods act as a double check on matters which are within the warranties of the guarantor of signature. See Section 8—312(3). In addition, to some extent, they act also as a check on the right to transfer (i. e. to deliver the security). Thus, an agent may be required to submit his power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit the usual "short-form certificate", etc. But failure of a fiduciary to obtain court approval of the transferor to comply with other requirements does not make his indorsement unauthorized. Section 8—308(7). Hence court orders and other controlling instruments are omitted from subsection (1).

Manifestly, it is impossible to check incumbency as of the moment when the security was delivered if presentment is made by the purchaser, or as of the moment of presentment in the more usual case of presentment by the seller. Therefore, subsection (1) (c) authorizes the issuer only to require "appropriate evidence" of appointment or incumbency, and subsection (3) indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified by a court, that evidence will be a court certificate dated within sixty days before the date of presentation; where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, subsection (3) (b) applies. Compare Section 4 of the Uniform Act for Simplification of Fiduciary Security Transfers. If the security is registered in the name of the indorsing fiduciary, the issuer may under Section 8—403(3) (a) assume without inquiry that the fiduciary status continues until written notice to the contrary is received; hence no evidence of appointment or incumbency is needed unless such a notice has been received. Compare Section 2 of the Uniform Act for Simplification of Fiduciary Security Transfers.

Where subsection (3) (b) applies, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certi-

ficate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If a document is obtained solely as "appropriate evidence of appointment or incumbency" under subsection (3) (b), the issuer is not charged with notice of its contents except to the extent that the contents relate directly to the appointment or incumbency. But if the document is obtained for any other purpose, the issuer may be so charged under subsection (4). See Point 6 below.

4. There are many other types of situations where, under the case law, the issuer would be deemed to have notice of possible adverse claims, and therefore would register transfer at its peril. Typical are: knowledge that the registered owner is dead, the fact that he is described or identifiable as a fiduciary, etc. Perhaps the most ubiquitous is where a will, trust indenture or other controlling instrument is on file with the issuer or transfer agent for some other purpose (e. g., in the banking as distinct from the corporate agency department of a trust company), but, unless specifically asked for, would not come to the attention of the officers responsible for the registration of security transfers. Here, under the cases, there is an area of liability based upon notice of possible adverse claims affecting the right to deliver the security, an area to which the warranties of the guarantor of signature specifically do not extend. See Section 8—312(3). Also, it is the area in which in the past issuers and their agents, fearing possible lawsuits based upon unauthorized transfers by fiduciaries and the like, have made it a practice to demand complete and convincing evidence that the transfer is proper in all of its aspects. Sections 8—403 and 8—404 strictly circumscribe the issuer's liability in such cases, and this section therefore makes no provision for assurances to cover them.

5. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances would be ignored at risk of absolute liability and to minimize that risk the issuer may properly exercise the option given by subsection (4) to require assurance beyond that specified in subsection (1). On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not operate, as they did under the prior law, automatically to create a duty of inquiry, unless there is timely notification of the existence of an adverse claim.



See Section 8—403(1) (a). If there is a duty of inquiry under Section 8—403, the issuer may follow the procedure provided in Section 8—403(2), or it may discharge the duty of inquiry “by any reasonable means”. The same is true if the issuer’s overriding duty to conduct its functions in good faith (Section 1—203) comes into play, e. g., where the security is indorsed by a person known to the employee handling the transaction for the issuer to be wanted by the police.

6. Specifically to implement the policy of this Act to discourage issuers from requiring excessive documentation, subsection (4) provides that if the issuer elects to require additional documentation for any purpose other than to obtain “appropriate evidence of appointment or incumbency” under subsection (3) (b), and both requires and obtains a copy of a will, trust, indenture, articles of co-partnership, by-laws or other controlling instrument, it is charged with notice of all matters contained therein affecting the transfer. It follows that an instrument

voluntarily submitted, without having been “required” by the issuer, may be returned without examination. But if the issuer has no duty to inquire and demands more than reasonable assurance that necessary indorsements are genuine and effective, the presenter of a security may refuse the demand and sue for improper refusal to register. Section 8—401.

#### Cross references:

Point 1: Sections 8—308, 8—311.

Point 2: Section 8—312.

Point 3: Sections 8—308, 8—312.

Point 4: Sections 8—312, 8—403, 8—404.

Point 5: Sections 1—203, 8—403.

Point 6: Section 8—401.

#### Definitional cross references:

“Adverse claim”. Section 8—301.

“Issuer”. Section 8—201.

“Notice”. Section 1—201.

“Person”. Section 1—201.

“Security”. Section 8—102.

“Sign”. Section 1—201.

### NORTH CAROLINA COMMENT

Under GS 25-8-401 (1) an issuer’s enforceable duty to register transfer does not arise absent “reasonable assurances” that indorsements are genuine and effective, unless the issuer chooses to waive them. GS 25-8-402 (1) specifies what assurances are “reasonable” for particular classes of transfers. This includes in all cases a signature guarantee (see GS 25-8-313 (1)) by a person “reasonably believed by the issuer to be responsible” under standards set by the issuer (GS 25-8-402 (2)). Fiduciaries may be required to furnish “appropriate evidence of appointment or incumbency” (GS 25-8-402 (1) (c)), which GS 25-8-402 (3) defines in terms nearly identical with the Simplification Act, GS 32-17. In order to implement the Code policy of discouraging excessive and costly documentation, the issuer may demand only a judicial certificate from a court-appointed fiduciary, or a copy of the basic document from all other fiduciaries. GS 25-8-402 (3), corre-

sponding to GS 32-17. Possession of such a document, including even a will or trust, does not put the issuer or transfer agent on notice as to any provision of the document bearing on the rightfulness of the transfer. See GS 25-8-402 (3) (b), corresponding to GS 32-17 (2). GS 25-8-402 (4), goes beyond the Simplification Act in affirmatively discouraging the issuer from demanding unnecessary documents by imputing notice of their contents, since the issuer does not need additional documentation to safeguard himself. Although he remains absolutely liable for registering transfer on a forged or unauthorized indorsement, GS 25-8-311 (b), the issuer’s protection comes, not from documents, comforting legal opinions, and the like, but from the signature guarantee which may always be required, GS 25-8-402 (1) (a). If desired, the issuer could obtain insurance or rely only upon insured signature guarantors, see GS 25-8-402 (3).

**§ 25-8-403. Limited duty of inquiry.**—(1) An issuer to whom a security is presented for registration is under a duty to inquire into adverse claims if

(a) a written notification of an adverse claim is received at a time and in a manner which affords the issuer a reasonable opportunity to act on it prior to the issuance of a new, reissued or re-registered security and the notification identifies the claimant, the registered owner and the issue of which the security is a part and provides an address for communications directed to the claimant; or

(b) the issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under subsection (4) of § 25-8-402.

(2) The issuer may discharge any duty of inquiry by any reasonable means,



including notifying an adverse claimant by registered or certified mail at the address furnished by him or if there be no such address at his residence or regular place of business that the security has been presented for registration of transfer by a named person, and that the transfer will be registered unless within thirty days from the date of mailing the notification, either

(a) an appropriate restraining order, injunction or other process issues from a court of competent jurisdiction; or

(b) an indemnity bond sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar or other agent of the issuer involved, from any loss which it or they may suffer by complying with the adverse claim is filed with the issuer.

(3) Unless an issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under subsection (4) of § 25-8-402 or receives notification of an adverse claim under subsection (1) of this section, where a security presented for registration is indorsed by the appropriate person or persons the issuer is under no duty to inquire into adverse claims. In particular

(a) an issuer registering a security in the name of a person who is a fiduciary or who is described as a fiduciary is not bound to inquire into the existence, extent, or correct description of the fiduciary relationship and thereafter the issuer may assume without inquiry that the newly registered owner continues to be the fiduciary until the issuer receives written notice that the fiduciary is no longer acting as such with respect to the particular security;

(b) an issuer registering transfer on an indorsement by a fiduciary is not bound to inquire whether the transfer is made in compliance with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer; and

(c) the issuer is not charged with notice of the contents of any court record or file or other recorded or unrecorded document even though the document is in its possession and even though the transfer is made on the indorsement of a fiduciary to the fiduciary himself or to his nominee. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 3, Uniform Fiduciaries Act.

**Changes:** Scope of exoneration broadened; duty of inquiry limited to defined situations.

In consonance with the general policy of this Part 4 (See the Comments to Sections 8—401 and 8—402), and subject always to the overriding duty of good faith in the performance of its functions (Section 1—203) this section limits the issuer's duty to inquire into adverse claims to the two specific situations stated in subsection (1).

#### Purposes of changes:

1. Paragraph (a) of subsection (1) is the ordinary "stop transfer" notice commonly resorted to by the owner of a lost or stolen security or in a situation where breach of trust, disregard of a valid restriction on transfer, or other improper action is feared to have occurred or to be about to occur.

Notification under paragraph (a) of subsection (1) (a) must be "written" within Section 1—201(46) and must be "received"

under Section 1—201(26) "at a time and in a manner which affords the issuer a reasonable opportunity to act on it prior to the issuance of a new, reissued or re-registered security". Cf. Section 1—201 (27). Its contents must be such as to make reasonably clear who makes the claim and with respect to what security, and where communications may be addressed to him. Compare Section 5(a) of the Uniform Act for Simplification of Fiduciary Security Transfers.

A notification once so received is easily keyed to the appropriate records. Therefore, no defense of "forgotten notice", possibly relevant on the issue of bona fide purchase as to bearer form securities, is available under this section.

As to paragraph (b) see the Comment to Section 8—402.

2. Subsection (2) does not limit the issuer to any specific method of discharging a duty of inquiry. It may use "any reasonable means" including the procedure spelled out in the subsection. That procedure, based on a New York statute re-

specting adverse claims to bank deposits and on commercial practice, should be effective in the large majority of cases to protect the rights of all interested parties and relieve the issuer of further responsibility. No delay during the thirty day period will be "unreasonable" under Section 8-401(2).

3. Subsection (3) is the converse of subsection (1) and spells out some specific situations in which under prior law a duty to inquire existed or may have existed. Compare Sections 2 and 3 of the Uniform Act for Simplification of Fiduciary Security Transfers. As to the effect

of subsection (3) (a) on the effectiveness of an indorsement, see the Comment to Section 8-404.

**Cross references:**

Sections 1-203, 8-304, 8-401, 8-402, 8-404, and 8-405.

**Definitional cross references:**

"Adverse claim". Section 8-301.

"Issuer". Section 8-201.

"Notice". Section 1-201.

"Notification". Section 1-201.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Security". Section 8-102.

### NORTH CAROLINA COMMENT

GS 25-8-403 extends the issuer's exoneration already recognized in North Carolina for fiduciary security transfers by the Uniform Fiduciaries Act, GS 32-4, and by the Simplification Act, GS 32-14 through 32-23, by substantially contracting the issuer's equitable obligation to inquire into all possible adverse claims. See also the comparable exoneration clause in the Uniform Gifts to Minors Act, GS 33-73. Under GS 25-8-403, no duty of inquiry arises unless the issuer receives a stop-transfer notice whose requirements of form (see GS 25-8-403 (1) (a)) enable the issuer or transfer agent to key the notice to its records or business machines. In this way, the normal routine for registering transfer will bring to light any stop-transfer notice duly re-

ceived. The issuer can discharge its limited duty of inquiry by notice to the claimant identified by the stop-transfer notice, and by waiting thirty days for the claimant to obtain a restraining order or post bond to protect the issuer (see GS 25-8-403 (2)). These provisions are consistent with, but more elaborate than, the counterpart clauses of the Simplification Act, GS 32-18, which lacks the Code procedure authorizing an indemnity bond in lieu of a court order. GS 25-8-403 (3) is identical in substance with the Simplification Act, GS 32-16. As indicated in the North Carolina Comment to GS 25-8-401, the Code represents the final stage in the gradual modification of the issuer's traditional duty to guarantee at its peril the rightfulness of all transfers of its securities.

**§ 25-8-404. Liability and non-liability for registration.**—(1) Except as otherwise provided in any law relating to the collection of taxes, the issuer is not liable to the owner or any other person suffering loss as a result of the registration of a transfer of a security if

(a) there were on or with the security the necessary indorsements (§ 25-8-308); and

(b) the issuer had no duty to inquire into adverse claims or has discharged any such duty (§ 25-8-403).

(2) Where an issuer has registered a transfer of a security to a person not entitled to it the issuer on demand must deliver a like security to the true owner unless

(a) the registration was pursuant to subsection (1); or

(b) the owner is precluded from asserting any claim for registering the transfer under subsection (1) of the following section [§ 25-8-405]; or

(c) such delivery would result in overissue, in which case the issuer's liability is governed by § 25-8-104. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. This section states the basic exoneration policy of this Article where the security is appropriately indorsed (Section 8-308) and there is no duty to inquire into adverse claims (Section 8-403).

Note that under subsection (1) (a) exoneration depends on whether or not the necessary indorsements were in fact on or with the security. The issuer cannot, for example, defend a suit based on its having registered a transfer on a forged indorsement on the ground that

it received the assurances listed in Section 8—402 and was under no duty to go further. It has that option under Section 8—402(4).

Note, however, that this Act excludes from the category of “unauthorized indorsement” (Section 8—311) certain situations which might have been included in that category under prior law, e. g., where there has been a change of circumstances subsequent to the signature (subsection (6) of Section 8—308); and where the signature is that of a fiduciary who has failed to obtain court approval of the transfer (subsection (7) of Section 8—308). Similarly, when an issuer acts on the assumption permitted by subsection (3) (a) of Section 8—403, that a fiduciary registered owner continues to act as such, the “necessary indorsement” under subsection (1) (a) of this section is that of the registered owner under Section 8—308(3) (b), even though a successor has in fact been appointed. In these and other cases, where the question is one affecting only the rightfulness of the transfer, the issuer need only establish that it had no duty under Section 8—403

to inquire into adverse claims or that it has discharged any such duty.

2. The registered owner's right to receive a new security where the issuer has wrongfully registered a transfer is established but the cases have also recognized his right to elect between an equitable action to compel issue of a new security and an action for damages. Cf. *Casper v. Kalt-Zimmers Mfg. Co.*, 159 Wis. 517, 149 N.W. 754 (1914). Such election of remedies is no longer available and the owner is now required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See Section 8—104.

#### Cross references:

Point 1: Sections 8—308, 8—402, 8—403.

Point 2: Sections 8—104 and 8—405.

#### Definitional cross references:

“Adverse claim”. Section 8—301.

“Deliver”. Section 1—201.

“Issuer”. Section 8—201.

“Notify”. Section 1—201.

“Overissue”. Section 8—104.

“Person”. Section 1—201.

“Security”. Section 8—102.

### NORTH CAROLINA COMMENT

GS 25-8-404 (1) saves the issuer from liability if a transfer is merely wrongful, provided the security has been duly indorsed, and the issuer has discharged its duty of inquiry. Hence, the fact that the transfer subsequently turns out to involve a breach of trust entails no issuer's liability. This is consistent with the Uniform Fiduciaries Act, GS 32-4; with *Carolina Tel. & Tel. v. Johnson*, 168 F.2d 489 (4th Cir. 1948) (construing the Uniform Fiduciaries Act); and with the Simplification Act, GS 32-19, and thus works no change in the law except to extend the estab-

lished North Carolina rule to all types of security transfers.

Outside the shelter of GS 25-8-404 (1), the issuer remains liable to the true owner. This continues the issuer's absolute liability for registering transfer on an unauthorized indorsement, GS 25-8-311 (b), or without performing its limited duty of inquiry under GS 25-8-404 (1) (b), or where the true owner of a security has given due notice of its loss, theft, or apparent destruction, GS 25-8-404 (2) (b), referring to GS 25-8-405 (1).

**§ 25-8-405. Lost, destroyed and stolen securities.**—(1) Where a security has been lost, apparently destroyed or wrongfully taken and the owner fails to notify the issuer of that fact within a reasonable time after he has notice of it and the issuer registers a transfer of the security before receiving such a notification, the owner is precluded from asserting against the issuer any claim for registering the transfer under the preceding section [§ 25-8-404] or any claim to a new security under this section.

(2) Where the owner of a security claims that the security has been lost, destroyed or wrongfully taken, the issuer must issue a new security in place of the original security if the owner

(a) so requests before the issuer has notice that the security has been acquired by a bona fide purchaser; and

(b) files with the issuer a sufficient indemnity bond; and

(c) satisfies any other reasonable requirements imposed by the issuer.

(3) If, after the issue of the new security, a bona fide purchaser of the original security presents it for registration of transfer, the issuer must register the transfer



unless registration would result in overissue, in which event the issuer's liability is governed by § 25-8-104. In addition to any rights on the indemnity bond, the issuer may recover the new security from the person to whom it was issued or any person taking under him except a bona fide purchaser. (1941, c. 353, s. 20; G. S., s. 55-100; 1955, c. 1371, s. 2; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 17, Uniform Stock Transfer Act.

**Changes:** In appropriate circumstances the issuer is now required to issue a new security in place of a lost, destroyed or stolen one without a court order.

**Purposes of changes:**

1. Subsection (1) applies explicitly the general rule of this Article on forged or unauthorized indorsements (Section 8—311). By failing to notify the issuer within a reasonable time after he knows or has reason to know of the loss or theft of his security, the owner is estopped from asserting the ineffectiveness of a forged or unauthorized indorsement and the wrongfulness of the registration of the transfer. If the lost security was indorsed by the owner then the registration of the transfer was not wrongful under Section 8—404 unless notice had been given to the issuer.

2. The long standing corporate practice of voluntarily issuing new securities to replace lost, destroyed or stolen ones is now incorporated into law. Where reasonable requirements are satisfied and a sufficient indemnity bond supplied, a court order is no longer necessary but, of course, the court may compel a recalcitrant issuer to take action.

3. Where an "original" security has reached the hands of a bona fide pur-

chaser, the registered owner who was in the best position to prevent the loss, destruction or theft of his security is now deprived of the new security issued to him as a replacement. This changes the prior law under which the original security was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a bona fide purchaser. *Keller v. Eureka Brick Mach. Mfg. Co.*, 43 Mo.App. 84, 11 L.R.A. 472 (1890). Where both the original and the new security have reached bona fide purchasers the issuer is now required to honor both securities unless an overissue would result and the security is not reasonably available for purchase. See Section 8—104. In the latter case alone, the bona fide purchaser of the original security is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

**Cross references:**

Sections 8—104, 8—311, 8—312, 8—402, 8—403 and 8—404.

**Definitional cross references:**

"Bona fide purchaser". Section 8—302.

"Issuer". Section 8—201.

"Notice". Section 1—201.

"Person". Section 1—201.

"Reasonable time". Section 1—204.

"Security". Section 8—102.

#### NORTH CAROLINA COMMENT

GS 25-8-405 states a uniform rule governing all lost, stolen or destroyed securities, and would replace two prior statutes applicable to stock certificates, GS 55-57 (e) and 55-91, as well as common-law rules applicable to bonds and other securities. Unlike prior statutes, GS 25-8-405 specifically extends its coverage to stolen certificates. GS 25-8-405 abandons the Stock Transfer Act's clumsy and little used requirement of a court order for a new certificate. Instead, like GS 55-57 (e), it recognizes the business custom of voluntarily issuing a new certificate on posting adequate bond. Unlike GS 55-57 (e), GS 25-8-405 (2) makes the issue of a new security an enforceable duty of the issuer even without a court order, provided that the conditions of GS 25-8-405 (2) (a)-(c) are met.

GS 25-8-405 (3) relieves the issuer of the

former liability in damages, see GS 55-91, to the bona fide transferee of the original certificate, and instead states new rules as follows:

(a) Despite issue of a replacement security, a bona fide purchaser of the original security is entitled to registration of transfer into his name, or to rights under GS 25-8-104 if registration would cause overissue. The issuer may then recover on the "sufficient indemnity bond," GS 25-8-405 (2) (b), or reclaim the replacement security, GS 25-8-405 (3). In this situation, only the bona fide purchaser of the original security is entitled to registration, and he is preferred because of the Code policy favoring free negotiability and because the original owner was, after all, best placed to avoid the original loss.

(b) If both the original and the replacement security are acquired by bona fide

purchasers, both must be registered. The issuer may not reclaim the replacement security, GS 25-8-405 (3), but could re-

cover on the indemnity bond, GS 25-8-405 (2) (b). Overissue would be dealt with under GS 25-8-104.

**§ 25-8-406. Duty of authenticating trustee, transfer agent or registrar.**—(1) Where a person acts as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of transfers of its securities or in the issue of new securities or in the cancellation of surrendered securities

(a) he is under a duty to the issuer to exercise good faith and due diligence in performing his functions; and

(b) he has with regard to the particular functions he performs the same obligation to the holder or owner of the security and has the same rights and privileges as the issuer has in regard to those functions.

(2) Notice to an authenticating trustee, transfer agent, registrar or other such agent is notice to the issuer with respect to the functions performed by the agent. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

Prior uniform statutory provision: None.

##### Purposes:

1. Transfer agents, registrars and the like are here expressly held liable to both the issuer and the owner for wrongful refusal to register a transfer as well as wrongful registration of a transfer in any case within the scope of their respective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefore refused to recognize their liability to the owner for mere non-feasance, i.e., refusal to register a transfer, are now rejected. *Hulse v. Consolidated Quicksilver Mining Corp.*, 65 Idaho 768, 154 P.2d 149 (1944); *Nicholson v. Morgan*, 119 Misc. 309, 196 N.Y. Supp. 147 (1922); *Lewis v. Hargadine-McKittrick Dry Goods Co.*, 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees of issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen now becomes obsolete in view of the provisions of the preceding section of this Article, which makes express provision for the issue of substitute securities. It can no longer be considered a breach of trust or lack of due diligence for trustees to authenticate such instruments. Cf. Switzerland General

*Ins. Co. v. New York Cent. & H. R. R. Co.*, 152 App.Div. 70, 136 N.Y.S. 726 (1912).

3. "Good faith and due diligence" require the use of reasonable care and the observance of "reasonable" commercial standards, and preclude arbitrary, capricious, over-cautious and super-technical objections and requirements. See *Powers v. Universal Film Mfg. Co.*, 162 App.Div. 806, 148 N.Y.S. 114 (1914). Compliance with the provisions of this Article as to the documents which an issuer may properly require before registering a transfer in cases where there has been no notice of adverse claims (Section 8-402) constitutes due diligence on the part of these agents and insisting upon more would incur liability for wrongful refusal to register a transfer.

##### Cross references:

Point 3: Sections 8-401, 8-402, 8-403 and 8-404.

See Sections 1-201, 8-208, 8-312, 8-401, 8-402, 8-403 and 8-405.

##### Definitional cross references:

"Good faith". Section 1-201.

"Holder". Section 1-201.

"Issuer". Section 8-201.

"Notice". Section 1-201.

"Person". Section 1-201.

"Security". Section 8-102.

#### NORTH CAROLINA COMMENT

GS 25-8-406 (1) (a) imposes upon the transfer agent a duty of good faith and due diligence running to the issuer, and GS 25-8-406 (1) (b) exacts of the transfer agent a like duty to every holder or owner of the security with whom he deals. Besides liability for misfeasance, the transfer agent is also liable for negligent inaction, e.g., refusal to register a transfer or undue

delay causing damage. This accords with North Carolina common-law rules making agents liable to third persons for nonfeasance. *Palomino Mills, Inc. v. Davidson Mills Corp.*, 230 N.C. 286, 52 S.E.2d 915 (1949); *Wachovia Bank & Trust Co. v. Southern Ry.*, 209 N.C. 304, 183 S.E. 630 (1936). A transfer agent fulfills his duty of due diligence both to the issuer and the

person presenting a security for registration of transfer, if he complies with the relevant Code provisions governing notice and inquiry, GS 25-8-403. Requiring unauthorized documentation, GS 25-8-402 (4),

or insisting upon an indorsement guarantee, GS 25-8-312 (2), may well result in liability for wrongfully refusing to register transfer. See GS 25-8-401 (2).

## ARTICLE 9.

### *Secured Transactions; Sales of Accounts, Contract Rights and Chattel Paper.*

#### NORTH CAROLINA COMMENT

Article 9 of the UCC is a comprehensive statutory scheme which would govern all security interests in personal property and fixtures, excepting a few noncommercial transactions. Oversimplification of the article would be misleading, for it is a complex and highly integrated statute which would supplant the existing statutes and case law relating to pledges, chattel mortgages, conditional sales, trust receipts, assignments of accounts receivable, factor's liens, agricultural crop liens and any other transaction intended to create a security interest in personal property.

The article adopts a functional, rather than formalistic, approach to the consequences of the security interest. Basically, the distinctions as to the rights and duties of the parties in various types of security transactions depend upon the type of collateral rather than on the form of the security agreement. GS 25-9-104 to 25-9-109. Further, the article would abolish technicalities such as the necessity of acknowledgment, establish a complete "notice filing" system such as is now in effect for factor's liens and trust receipts, GS 25-9-401 to 25-9-403; and provide a single integrated system of priorities. GS 25-9-301 and 25-9-312. It would liberalize the rights of the secured party on default in a manner similar to the Uniform Trust Receipts Act. GS 25-9-501 to 25-9-507.

Another significant substantive modification and clarification would be the general validation of the "floating lien" through express recognition of the validity of after-acquired property clauses and future advances provisions, GS 25-9-204, and by abolition of control of the debtor over the collateral and proceeds as a test for validity of the security agreement. GS 25-9-205. Due to the absence of decisions concerning the Factor's Lien Act and Accounts Receivable Act in North Carolina it is perhaps impossible to accurately judge whether the Code makes significant changes in those laws insofar as the floating lien is concerned. Nevertheless, those acts did recognize the concept. Article 9 makes express much of that which was unclear and extends the availability of the device to all persons financing inventory or the manufacturing of goods.

In general the article gives increased flexibility to the secured party and the debtor. It provides for perfection of security interests in consumer goods and certain farm equipment without filing. GS 25-9-302. It gives the consumer complete protection from the security interests in the seller's inventory, thus expanding the protection now available in only three situations in North Carolina. GS 25-9-307.

There are many more changes which this article of the Code makes in North Carolina law; there are many places where the Code merely supplements prior law. But the details are not to be had in one page. Suffice it to say at this point that article 9 does not abandon all knowledge which antedates it. Its adoption has not plunged interested parties into a completely foreign world. The terminology is for the most part new; but once it is mastered, the concepts resulting therefrom are familiar.

## PART 1.

### SHORT TITLE, APPLICABILITY AND DEFINITIONS.

§ 25-9-101. **Short title.**—This article shall be known and may be cited as Uniform Commercial Code—Secured Transactions. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

This Article sets out a comprehensive scheme for the regulation of security interests in personal property and fixtures. It supersedes existing legislation dealing with such security devices as chattel mortgages, conditional sales, trust receipts,



factor's liens and assignments of accounts receivable (see Note to Section 9—102).

Consumer instalment sales and consumer loans present special problems of a nature which makes special regulation of them inappropriate in a general commercial codification. Many states now regulate such loans and sales under small loan acts, retail instalment selling acts and the like. While this Article applies generally to security interests in consumer goods, it is not designed to supersede such regulatory legislation (see Notes to Sections 9—102 and 9—203). Nor is this Article designed as a substitute for small loan acts or retail instalment selling acts in any state which does not presently have such legislation.

Existing law recognizes a wide variety of security devices, which came into use at various times to make possible different types of secured financing. Differences between one device and another persist, in formal requisites, in the secured party's rights against the debtor and third parties, in the debtor's rights against the secured party, and in filing requirements, despite the fact that today many of those differences no longer serve any useful function. Thus an unfiled chattel mortgage is by the law of many states "void" against creditors generally; a conditional sale, often available as a substitute for the chattel mortgage, is in some states valid against all creditors without filing, and in states where filing is required is, if unfiled, void only against lien creditors. The recognition of so many separate security devices has the result that half a dozen filing systems covering chattel security devices may be maintained within a state, some on a county basis, others on a state-wide basis, each of which must be separately checked to determine a debtor's status.

Nevertheless, despite the great number of security devices there remain gaps in the structure. In many states, for example, a security interest cannot be taken in inventory or a stock in trade although there is a real need for such financing. It is often baffling to try to maintain a technically valid security interest when financing a manufacturing process, where the collateral starts out as raw materials, becomes work in process and ends as finished goods. Furthermore, it is by no means clear, even to specialists, how under present law a security interest may be taken in many kinds of intangible property—such as television or motion picture rights—which have come to be an important source of commercial collateral.

While the chattel mortgage is adaptable for use in almost any situation where goods are collateral, there are limitations, sometimes highly technical, on the use of other devices, such as the conditional sale and particularly the trust receipt. The cases are many in which a security transaction described by the parties as a conditional sale or a trust receipt has been later determined by a court to be something else, usually a chattel mortgage. The consequence of such a determination is typically to void the security interest against creditors because the security agreement was not filed as a *chattel mortgage* (even though it may have been filed as a conditional sale or a trust receipt). In recent years our security law has grown in complexity at an alarming rate. The already mentioned difficulty of financing on the security of inventory has been got around to some extent by the device known as "field warehousing" as well as by the use of the trust receipt. Since 1940 a number of states have generally authorized inventory financing by enacting statutes, similar although not uniform, known as "factor's lien" acts. Also in the period since 1940 the increasingly important business of lending against accounts receivable has inspired new statutes in that field in more than thirty states.

The growing complexity of financing transactions forces us to keep piling new statutory provisions on top of our inadequate and already sufficiently complicated nineteenth-century structure of security law. The results of this continuing development are, and will be, increasing costs to both parties and increasing uncertainty as to their rights and the rights of third parties dealing with them.

The aim of this Article is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty.

Under this Article the traditional distinctions among security devices, based largely on form, are not retained; the Article applies to all transactions intended to create security interests in personal property and fixtures, and the single term "security interest" substitutes for the variety of descriptive terms which has grown up at common law and under a hundred-year accretion of statutes. This does not mean that the old forms may not be used, and Section 9—102 (2) makes it clear that they may be.

This Article does not determine whether "title" to collateral is in the secured party or in the debtor and adopts neither a

"title theory" nor a "lien theory" of security interests. Rights, obligations and remedies under the Article do not depend on the location of title (Section 9—202). The location of title may become important for other purposes—as, for example, in determining the incidence of taxation—and in such a case the parties are left free to contract as they will. In this connection the use of a form which has traditionally been regarded as determinative of title (e. g., the conditional sale) could reasonably be regarded as evidencing the parties' intention with respect to title to the collateral.

Under the Article distinctions based on form (except as between pledge and non-possessory interests) are no longer controlling. For some purposes there are distinctions based on the type of property which constitutes the collateral—industrial and commercial equipment, business inventory, farm products, consumer goods, accounts receivable, documents of title and other intangibles—and, where appropriate, the Article states special rules applicable to financing transactions involving a particular type of property. Despite the statutory simplification a greater degree of flexibility in the financing transaction is allowed than is possible under existing law.

**§ 25-9-102. Policy and scope of article.**—(1) Except as otherwise provided in § 25-9-103 on multiple state transactions and in § 25-9-104 on excluded transactions, this article applies so far as concerns any personal property and fixtures within the jurisdiction of this State

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights; and also

(b) to any sale of accounts, contract rights or chattel paper.

(2) This article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This article does not apply to statutory liens except as provided in § 25-9-310.

(3) The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

#### Purposes:

The purpose of this section is to bring all consensual security interests in personal property and fixtures, with the exception of certain types of transactions excluded by Sections 9—103 and 9—104, under this Article, as well as sales of accounts, contract rights and chattel paper whether intended for security or not un-

The scheme of the Article is to make distinctions, where distinctions are necessary, along functional rather than formal lines.

This has made possible a radical simplification in the formal requisites for creation of a security interest.

A more rational filing system replaces the present system of different files for each security device which is subject to filing requirements. Thus not only is the information contained in the files made more accessible but the cost of procuring credit information, and, incidentally, of maintaining the files, is greatly reduced.

The Article's flexibility and simplified formalities should make it possible for new forms of secured financing, as they develop, to fit comfortably under its provisions, thus avoiding the necessity, so apparent in recent years, of year by year passing new statutes and tinkering with the old ones to allow legitimate business transactions to go forward.

The rules set out in this Article are principally concerned with the limits of the secured party's protection against purchasers from and creditors of the debtor. Except for procedure on default, freedom of contract prevails between the immediate parties to the security transaction.

less excluded by Section 9—104(f). As to security interests in fixtures created under the law applicable to real estate, see Section 9—313(1).

1. Except for sales of accounts, contract rights and chattel paper, the principal test whether a transaction comes under this Article is: Is the transaction intended to have effect as security? For example, Section 9—104 excludes certain transac-

tions where the security interest (such as an artisan's lien) arises under statute or common law by reason of status and not by consent of the parties. Transactions in the form of consignments or leases are subject to this Article if the understanding of the parties or the effect of the arrangement shows that a security interest was intended. (As to consignments the provisions of Section 2—326 of Article 2 (Sales) should be consulted.) When it is found that a security interest as defined in Section 1—201(37) was intended, this Article applies regardless of the form of the transaction or the name by which the parties may have christened it. The list of traditional security devices in subsection (2) is illustrative only; other old devices, as well as any new ones which the ingenuity of lawyers may invent, are included, so long as the requisite intent is found. The controlling definition is that contained in subsection (1). In connection with the inclusion of "equipment trust" in the subsection (2) list, it should be noted that Section 9—104(e) excludes from the Article equipment trust on railway rolling stock.

2. The Article does not in terms abolish existing security devices. The conditional sale or bailment-lease for example is not prohibited; but even though it is used, the rules of this Article govern.

3. In general this Article adopts the position, implicit in prior law, that the law of the state where the collateral is located should be the governing law, without regard to possible contacts in other jurisdictions. Thus the applicability of the Article is by this section stated to extend

to transactions concerning "personal property and fixtures within the jurisdiction of this state". This "narrow" approach, appropriate in the field of security transactions, should be contrasted with the "broad" approach stated in Section 1—105 with reference to the applicability of the Act as a whole. Section 9—103 states special rules relating to the applicability of this Article where the collateral consists of certain types of intangibles or mobile equipment, or property which is brought into this state subject to a security interest which attached in another jurisdiction.

4. An illustration of subsection (3) is as follows:

The owner of Blackacre borrows \$10,000 from his neighbor, and secures his note by a mortgage on Blackacre. This Article is not applicable to the creation of the real estate mortgage. However, when the mortgagee in turn pledges this note and mortgage to secure his own obligation to X, this Article is applicable to the security interest thus created in the note and the mortgage. Whether the transfer of the collateral for the note, i. e., the mortgagee's interest in Blackacre, requires further action (such as recording an assignment of the mortgagee's interest) is left to real estate law. See Section 9—104(j).

5. While most sections of this Article apply to a security interest without regard to the nature of the collateral or its use, some sections state special rules with reference to particular types of collateral. An index of sections where such special rules are stated follows:

## ACCOUNTS AND CONTRACT RIGHTS

### Section

- 9—102(1)(b) Sale of accounts and contract rights subject to Article
- 9—103(1) When Article applies; conflict of laws rules
- 9—104(f) Certain sales of accounts and contract rights excluded from Article
- 9—106 Definitions
- 9—204(2)(c) and (d) When debtor acquires rights
- 9—205 Permissible for debtor to make collections
- 9—206(1) Agreement not to assert defenses against assignee
- 9—301(1)(d) Unperfected security interest subordinate to certain transferees
- 9—302(1)(e) What assignments need not be filed
- 9—306(5) Rule when goods whose sale gave rise to an account return to seller's possession
- 9—318(1) Rights of assignee subject to defenses
- 9—318(2) Modification of contract after assignment of contract right
- 9—318(3) When account debtor may pay assignor
- 9—318(4) Term prohibiting assignment ineffective
- 9—401 Place of filing
- 9—502 Collection rights of secured party
- 9—504(2) Rights on default where underlying transaction was sale of accounts or contract rights



## CHATTEL PAPER

## Section

- 9—102(1)(b) Sale subject to Article
- 9—104(f) Certain sales excluded from Article
- 9—105(1)(b) Definition
- 9—205 Permissible for debtor to make collections
- 9—206(1) Agreement not to assert defenses against assignee
- 9—207(1) Duty of secured party in possession to preserve rights against prior parties
- 9—301(1)(c) Unperfected security interest subordinate to certain transferees
- 9—304(1) Perfection by filing
- 9—305 When possession by secured party perfects security interest
- 9—306(5) Rule when goods whose sale results in chattel paper return to seller's possession
- 9—308 When purchasers of chattel paper have priority over security interest
- 9—318(1) Rights of assignee subject to defenses
- 9—318(3) When account debtor may pay assignor
- 9—502 Collection rights of secured party
- 9—504(2) Rights on default where underlying transaction was sale

## DOCUMENTS AND INSTRUMENTS

- 9—105(1)(e) Definition of document (and see 1—201)
- 9—105(1)(g) Definition of instrument
- 9—206(1) Rule where buyer of goods signs both negotiable instrument and security agreement
- 9—207(1) Duty of secured party in possession of instrument to preserve rights against prior parties
- 9—301(1)(c) Unperfected security interest subordinate to certain transferees
- 9—302(1)(b) and (f) What interests need not be filed
- 9—304(1) How security interest can be perfected
- 9—304(2, 3) Perfection of security interest in goods in possession of issuer of negotiable document or of other bailee
- 9—304(4, 5) Perfection of security interest in instruments or negotiable documents without filing or transfer of possession
- 9—305 When possession by secured party perfects security interest
- 9—308 When purchasers of non-negotiable instruments have priority over security interest
- 9—309 When purchasers of negotiable instruments or negotiable documents have priority over security interest
- 9—501(1) Rights on default where collateral is documents
- 9—502 Collection rights of secured party

## GENERAL INTANGIBLES

- 9—103(2) When Article applies; conflict of laws rules
- 9—105 Obligor is "account debtor"
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- 9—301(1)(d) Unperfected security interest subordinate to certain transferees
- 9—318(1) Rights of assignee subject to defenses
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## GOODS

(See also Consumer Goods, Equipment, Farm Products, Inventory)

- 9—103(2) When Article applies with regard to goods of a type normally used in more than one jurisdiction; conflict of laws rules
- 9—105(1)(f) Definition
- 9—109 Classification of goods as consumer goods, equipment, farm products and inventory
- 9—203 Formal requisites of security agreement covering certain types of goods (crops, oil, gas, minerals or timber)
- 9—204(2)(b) When debtor acquires rights in certain types of goods (crops, fish, timber, oil, gas, minerals)
- 9—204(4) Validity of after-acquired property clause covering certain types of goods (crops, consumer goods)

**Section**

- 9-205 Permissible for debtor to accept returned goods
- 9-206(2) When security agreement can limit or modify warranties on sale
- 9-301(1)(c) Unperfected security interest subordinate to certain transferees
- 9-304(2, 3) Perfection of security interest in goods in possession of issuer of negotiable document or of other bailee
- 9-304(5) Perfection of security interest without filing or transfer of possession where goods in possession of certain bailees
- 9-305 When possession by secured party perfects security interest
- 9-306(5) Rule when goods whose sale gave rise to account or chattel paper return to seller's possession
- 9-307 When buyers of goods from debtor take free of security interest
- 9-313 Goods which are or become fixtures
- 9-314 Goods affixed to other goods
- 9-315 Goods commingled in a product
- 9-402 Place of filing for fixtures
- 9-401(1)(c) Form of financing statement covering fixtures
- 9-504(1) Sale of goods by secured party after default subject to Article 2 (Sales)

**CONSUMER GOODS**

- 9-109(1) Definition
- 9-203(2) Transaction, although subject to this Article, may also be subject to certain regulatory statutes
- 9-204(4)(b) Validity of after-acquired property clause
- 9-206(1) Buyer's agreement not to assert defenses against an assignee subject to statute or decision which establishes rule for buyers of consumer goods
- 9-302(1)(d) When filing not required
- 9-307(2) When buyers from debtor take free of security interest
- 9-401(1)(a) Place of filing
- 9-505(1) Secured party's duty to dispose of repossessed consumer goods
- 9-507(1) Secured party's liability for improper disposition of consumer goods after default

**EQUIPMENT**

- 9-103(2) When Article applies with regard to certain types of equipment normally used in more than one jurisdiction; conflict of laws rules
- 9-109(2) Definition
- 9-302(1)(c) When filing not required to perfect security interest in certain farm equipment
- 9-307(2) When buyers of certain farm equipment from debtor take free of security interest
- 9-401(1) Place of filing for equipment used in farming operation
- 9-503 Secured party's right after default to remove or to render equipment unusable

**FARM PRODUCTS**

- 9-109(3) Definition
- 9-203(1)(b) Formal requisites of security agreement covering crops
- 9-204(2)(a) When debtor acquires rights in crops
- 9-204(4)(a) Validity of after-acquired property clause in crops
- 9-307 When a buyer of farm products takes free of security interest
- 9-312(2) Priority of secured party who gives new value to enable debtor to produce crops
- 9-401(1)(b) Place of filing
- 9-402(1) and (3) Form of financing statement covering crops

**INVENTORY**

- 9-103(2) When Article applies with regard to certain types of inventory normally used in more than one jurisdiction; conflict of laws rules
- 9-109(4) Definition
- 9-306(5) Rule where goods whose sale gave rise to account or chattel paper return to seller's possession
- 9-307(1) When buyers from debtor take free of security interest
- 9-312(3) When purchase money security interest takes priority over conflicting security interest

**Cross references:**

Sections 9—103 and 9—104.

Point 1: Section 2—326.

Point 2: Section 1—105.

**Definitional cross references:**

"Account". Section 9—106.

"Chattel paper". Section 9—105.

"Contract". Section 1—201.

"Contract right". Section 9—106.

"Document". Section 9—105.

"General intangibles". Section 9—106.

"Goods". Section 9—105.

"Instrument". Section 9—105.

"Security interest". Section 1—201.

**NORTH CAROLINA COMMENT**

This section states the basic coverage of article 9. That is, all consensual transactions intended to create a security interest in personal property and fixtures, except those situations covered by GS 25-9-104, must be created under article 9 and are subject to the provisions of article 9.

The initial choice of law determination is governed by the physical location of the collateral at the time of the creation of the security interest, except as to the types of collateral set out in GS 25-9-103.

The policy of this article is to govern all security interests regardless of the form the transaction might take. And distinctions between various transactions would no longer be made by reference to the form of the transactions, rather distinctions would be made by reference to the type of collateral, and other factors. The abolition of the consequences of form began long ago in North Carolina and the court has consistently held chattel mortgages and conditional sales have essentially the same consequences. See *Observer Co. v. Little*, 175 N.C. 42, 94 S.E. 526 (1917). Furthermore, until the enactment of the Uniform Trust Receipts Act in this State, the court treated as conditional

sales security interests which were denominated "trust receipts." See *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960); *General Motors Acceptance Corp. v. Mayberry*, 195 N.C. 508, 142 S.E. 767 (1928).

The Code completes the process of abolition of form, and the following types of security interests formerly recognized in North Carolina fall within the provisions of article 9:

(1) Chattel mortgages, deeds of trust on personal property and fixtures, and conditional sales contracts.

(2) Pledges.

(3) Factor's liens.

(4) Liens on accounts receivable.

(5) Trust receipts.

(6) Agricultural liens on crops for advances.

This is not to say that the words may not be used, nor that the prior forms cannot be used (although it would probably be preferable to make new forms to obtain maximum advantage of the Code). But whatever form is used, it can have no effect on the operation of the Code and the security interest would be regulated thereunder.

**§ 25-9-103. Accounts, contract rights, general intangibles and equipment relating to another jurisdiction; and incoming goods already subject to a security interest.**—(1) If the office where the assignor of accounts or contract rights keeps his records concerning them is in this State, the validity and perfection of a security interest therein and the possibility and effect of proper filing is governed by this article; otherwise by the law (including the conflict of laws rules) of the jurisdiction where such office is located.

(2) If the chief place of business of a debtor is in this State, this article governs the validity and perfection of a security interest and the possibility and effect of proper filing with regard to general intangibles or with regard to goods of a type which are normally used in more than one jurisdiction (such as automotive equipment, rolling stock, airplanes, road building equipment, commercial harvesting equipment, construction machinery and the like) if such goods are classified as equipment or classified as inventory by reason of their being leased by the debtor to others. Otherwise, the law (including the conflict of laws rules) of the jurisdiction where such chief place of business is located shall govern. If the chief place of business is located in a jurisdiction which does not provide for perfection of the security interest by filing or recording in that jurisdiction, then the security interest may be perfected by filing in this State. For the purpose of determining the validity and perfection of a security interest in an airplane, and chief place of business of a debtor who is a foreign air carrier under the Federal Aviation Act of 1958, as



amended, is the designated office of the agent upon whom service of process may be made on behalf of the debtor.

(3) If personal property other than that governed by subsections (1) and (2) is already subject to a security interest when it is brought into this State, the validity of the security interest in this State is to be determined by the law (including the conflict of laws rules) of the jurisdiction where the property was when the security interest attached. However, if the parties to the transaction understood at the time that the security interest attached that the property would be kept in this State and it was brought into this State within 30 days after the security interest attached for purposes other than transportation through this State, then the validity of the security interest in this State is to be determined by the law of this State. If the security interest was already perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this State, the security interest continues perfected in this State for four months and also thereafter if within the four-month period it is perfected in this State. The security interest may also be perfected in this State after the expiration of the four-month period; in such case perfection dates from the time of perfection in this State. If the security interest was not perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this State, it may be perfected in this State; in such case perfection dates from the time of perfection in this State.

(4) Notwithstanding subsections (2) and (3), if personal property is covered by a certificate of title issued under a statute of this State or any other jurisdiction which requires indication on a certificate of title of any security interest in the property as a condition of perfection, then the perfection is governed by the law of the jurisdiction which issued the certificate.

(5) Notwithstanding subsection (1) and § 25-9-302, if the office where the assignor of accounts or contract rights keeps his records concerning them is not located in a jurisdiction which is a part of the United States, its territories or possessions, and the accounts or contract rights are within the jurisdiction of this State or the transaction which creates the security interest otherwise bears an appropriate relation to this State, this article governs the validity and perfection of the security interest and the security interest may only be perfected by notification to the account debtor. (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1.)

**Editor's Note.** — The last sentence of subsection (2) and all of subsection (5) are optional in the 1962 Official Text of the UCC.

#### OFFICIAL COMMENT

**Prior uniform statutory provisions:** Subsection (3)—Section 14, Uniform Conditional Sales Act.

**Changes:** Completely rewritten.

**Purposes of changes:**

1. Under Section 9—102 this Article applies to the transactions described in that Section "so far as concerns any personal property and fixtures within the jurisdiction of this state". That is equivalent to saying, in most cases, that the Article applies when the collateral is physically located in this state. This section amplifies that general principle and states special rules in three situations which have given difficulty under earlier statutes. Subsections (1) and (2) in effect state when this state claims jurisdiction over accounts and contract rights (subsection (1)) and over mobile equipment and general intangibles (subsection (2)). Subsection (3) deals

with the problem of collateral brought into this state subject to a security interest which attached elsewhere.

2. The general rule of Section 9—102 is difficult of application with respect to certain types of intangible collateral. This Article classifies intangible property as instruments (defined in Section 9—105 to include investment securities as well as conventional negotiable instruments), documents (defined in Sections 9—105 and 1—201 to include bills of lading, warehouse receipts and the like), chattel paper (defined in Section 9—105), accounts, contract rights and general intangibles (defined in Section 9—106). The general rule is appropriate and applies to instruments, documents and chattel paper: in contemplation of law and by common understanding and practice the property right or claim evidenced by an instrument, docu-

ment or chattel paper is thought of as being merged in or symbolically represented by the piece of paper, whose indorsement or delivery is a prerequisite to a transfer of the underlying claim or right. This Article therefore applies to security interests in instruments, documents, and chattel paper when the relevant pieces of paper are in this state.

Accounts, contract rights and general intangibles do not fit that simple pattern. As to them there is no indispensable or symbolic document which represents the underlying claim, whose indorsement or delivery is the one effectual means of transfer.

There is a considerable body of case law dealing with the situs of choses in action. This case law is in the highest degree confused, contradictory and uncertain; it affords no base on which to build a statutory rule.

An account receivable arises typically out of a sale; the contract of sale may be executed in State A, the goods shipped from a warehouse in State B to the buyer (account debtor) in State C. The account may then be assigned to an assignee in State D. The seller-assignor may keep his principal records in State E. Under the non-notification system of accounts receivable financing, the seller-assignor, despite the assignment, bills and collects from the account debtor; under notification financing the account debtor makes payment to the assignee, but the bills may be prepared and sent out by either assignor or assignee. The contacts of the transaction are with many jurisdictions: to which one is it appropriate to look for the governing law?

All this applies with equal force to contract rights. Even more complicated situations may be anticipated when the collateral consists of novel or uncommon types of personal property, which fall within the definition of general intangibles.

If we bear in mind that one of the principal questions involved is where certain financing statements shall be filed, two things become clear. *First*: since the purpose of filing is to allow subsequent creditors of the *debtor-assignor* to determine the true status of his affairs, the place chosen must be one which such creditors would normally associate with the assignor; thus the place of business of the assignee and the places of business or residences of the various account debtors must be rejected. *Second*: since the validity of the assignment against third parties may depend on the filing of a financing statement in the proper place, it is vital that

the place chosen be one which can be determined with the least possible risk of error.

Subsection (1), following some of the existing state statutes, adopts the rule that security interests in accounts or contract rights are covered when the office of the assignor where he keeps his records concerning them is in this state. Since general intangibles are not closely associated with particular records, a different rule (subsection (2) and Comment 5) is adopted for them.

In a state in which under this Article filing with reference to assignments of accounts and contract rights is generally in a state and not a county office, no problem arises under the subsection (1) rule if all the assignor's places of business are in this state. As to the optional provision for county filing, see Section 9-401 and Comment. For the multi-state business there is no easy solution. The office where the assignor keeps his records of accounts or contract rights will be typically the principal financial office of the enterprise. Frequently records of an account may be kept in several offices; for example, in the branch office where the account debtor placed his order and in the warehouse from which the goods were shipped as well as in the principal financial office: in such a case, it is the internal practice of the assignor—i. e., which of the various records is controlling for general accounting purposes of the enterprise—that determines whether the law of this state or of some other jurisdiction shall apply. In the great majority of cases the test of subsection (1) is easy to apply; some situations remain, which will have to be worked out on a case by case basis, and which neither this nor any other statutory formula can settle in advance beyond the possibility of a doubt. There is, however, one easy answer: if there might be more than one state in which it could be claimed that the assignor keeps his records, let the assignee file in all such states. Filing is simple and inexpensive, and the entire problem can thereby be avoided.

If the record-keeping office is moved into "this state" after a security interest has been perfected under the law of another jurisdiction, the secured party should file in this state, since Section 9-401(3) is inapplicable.

3. Another class of collateral for which a special rule is stated (subsection (2)) is mobile goods which are normally moved for use from one jurisdiction to another. Such goods are generally classified as equipment; occasionally they may be clas-

sified as inventory, for example, autos owned by a car rental agency. Under many present chattel mortgage and conditional sales acts the mortgagee or conditional vendor must file in each filing district in which such mobile equipment is used—which is possible although onerous in some cases, but not even possible in the case, for example, of non-scheduled trucking operations. Subsection (2) provides that a security interest in such equipment or inventory is subject to this Article when the debtor's chief place of business is in this state. "Chief place of business" does not mean the place of incorporation; it means the place from which in fact the debtor manages the main part of his business operations. That is the place where persons dealing with the debtor would normally look for credit information, and is the appropriate place for filing. The term "chief place of business" is not defined in this section or elsewhere in this Act. Doubt may arise as to which is the "chief place of business" of a multi-state enterprise with decentralized, autonomous regional offices. A secured party in such a case may easily protect himself at no great additional burden by filing in each of several places. Although under this formula, as under the accounts receivable rule stated in subsection (1), there will be doubtful situations, the subsection states a rule which will be simple to apply in most cases, which will make it possible to dispense with much burdensome and useless filing, and which will operate to preserve a security interest in the case of non-scheduled operations.

Similarly, if the chief place of business of the debtor is moved into "this state" after a security interest has been perfected in another jurisdiction, the secured party should file in this state, since Section 9—401(3) is inapplicable.

Section 9—302(3) should be consulted for certain transactions to which the filing provisions of this Article do not apply. Where property is covered by a certificate of title, the governing rule is stated in subsection (4) of this section.

4. Notice that the rule of subsection (2) applies to goods of a type "normally used" in more than one jurisdiction; there is no requirement that particular goods be in fact used out of state. Thus if an enterprise whose chief place of business is in State X keeps in this state goods of the type covered by subsection (2), this rule of the subsection applies even though the goods never cross a state line. The definitions of "equipment" and "inventory" (Section 9—109) should be consulted.

5. General intangibles present the same problem as accounts and contract rights, but with an added difficulty. The "office where records are kept" rule which subsection (1) applies to accounts and contract rights is not available here since no records will be kept with respect to many types of property which would be "general intangibles". The "chief place of business" rule of subsection (2) is adopted as providing a convenient filing place. If the debtor's chief place of business is moved into "this state" after a security interest has been perfected in another jurisdiction, the secured party should file in this state, since Section 9—401(3) is inapplicable.

6. Under subsection (1) this state in effect disclaims jurisdiction over certain accounts and contract rights and under subsection (2) over general intangibles which, by common law rules, might be held to be within the state's jurisdiction; in the same way under subsection (2) there is a disclaimer of jurisdiction over mobile chattels even though they are physically located here. So far as validity, perfection and filing are concerned, the subsections state the rule that the applicable law, if it is not the law of this state, will be that of the jurisdiction where the assignor keeps his records of accounts or contract rights, or in the case of mobile chattels or general intangibles where the debtor's chief place of business is located. If the jurisdiction whose law is applicable has enacted this Article or comparable legislation, filing, for example, in that jurisdiction will be recognized in this state as perfecting the security interest here. The other jurisdiction may, however, not have such legislation. For example, mobile equipment is located in this state; the debtor's chief place of business is in State X, which has not enacted this Article. Presumably State X will not permit or recognize filing on property not physically located in State X. Subsections (1) and (2) solve this difficulty by making specific reference to the conflict of laws rules of State X. If the law of State X does not assert the jurisdiction which is disclaimed by the subsections, then the applicable law will be the law which the courts of State X would apply to the transaction under their conflict of laws principles. In the case of mobile equipment, that would be presumably this state, where the equipment is located, and so filing in this state would perfect the interest. In the case of accounts, contract rights and general intangibles it would be the jurisdiction where the property is deemed located un-



der the State X case law on the situs of choses in action.

It is clear that cases may arise where the application of these rules will not be a simple matter. It is thought however that the advantages of the rules far outweigh these difficulties—which indeed already exist under several state accounts receivable statutes. The incorporation of the other jurisdiction's conflict of laws rules makes it possible to arrive at a solution in any given case. Where both jurisdictions have enacted this Article or comparable legislation, there is no difficulty in applying the rules.

The optional sentence at the end of subsection (2) provides a special rule for security interests in airplanes owned by a foreign air carrier. Without that sentence subsection (2) may refer such a case to the law of a foreign nation whose law is difficult or impossible to ascertain, and there may be doubt as to whether the third sentence of subsection (2) is applicable so as to permit perfection by filing "in this state." The optional sentence clears up such doubts by treating as the chief place of business the office designated for service of process in the United States under the Federal Aviation Act of 1958. To the extent that it is applicable, the Convention on the International Recognition of Rights in Aircraft supersedes state legislation on this subject, but many nations are not parties to that Convention.

7. Collateral other than accounts, contract rights, general intangibles and mobile equipment may be brought into this state subject to a security interest which has attached and may have been perfected under the laws of another jurisdiction. If the property is covered by a certificate of title, subsection (4) applies. In other cases, under subsection (3) this Article applies from the time the collateral comes into this state, except that (1) the validity of the security interest is determined by the law of the jurisdiction where it attached (unless pursuant to an understanding of the parties the collateral is brought here within 30 days thereafter) and (2) if the security interest was perfected in the jurisdiction where the collateral was kept before being brought here, it continues perfected in this state for four months after the collateral is brought in, although the filing requirements of this Article have not been complied with here. After the four month period the secured party must comply with the perfection requirements of this Article (i. e., must file if filing is required). This rule differs from that of Section 14 of the Uniform Conditional Sales

Act. Under that section a conditional seller was required to file within 10 days after he "received notice" that the goods had been removed into this state. Apparently, under the Uniform Conditional Sales Act, if the seller never "received notice" his interest continued or became perfected in this state without filing, whether or not it had been perfected in the original jurisdiction. Subsection (3) proceeds on the theory that not only the secured party whose collateral has been removed but also creditors of and purchasers from the debtor in this state should be considered. The four month period is long enough for a secured party to discover in most cases that the collateral has been removed and to file in this state; thereafter, if he has not done so, his interest, although originally perfected in the state where it attached, is subject to defeat here by those persons who take priority over an unperfected security interest (see Section 9—301). Under Section 9—312(5) the holder of a perfected conflicting security interest is such a person even though during the four month period the conflicting interest was junior. Compare the situation arising under Section 9—403 (2) when a filing lapses.

In case of delay beyond the four-month period, there is no "relation back"; and this is also true where, in this state, the security interest is perfected for the first time.

Note that even after the four-month period, it is the law of the jurisdiction where the security interest attached which determines its validity. That is to say, such matters as formal requisites continue to be tested by the law with reference to which the parties originally contracted. Other matters (rights of third parties, rights on default and so on) are governed by this Article.

Subsection (3) does not apply to the case of goods removed from one filing district to another within this state (see subsection (3) of Section 9—401), but only to property brought into this state from another jurisdiction (i. e., from another state, from a foreign country, or from federal territory).

8. Optional subsection (5) makes an exception to subsection (1) and to Section 9—302 on the requirement of filing. Where subsection (1) refers to the law of a foreign nation for the validity and perfection of a security interest in accounts or contract rights, the governing law may be difficult or impossible to ascertain. Subsection (5) therefore provides a substitute rule for such cases. If the transaction is one which bears an appropriate relation

to this state. Compare Sections 1—105, 9—102. If a buyer of goods in this state (account debtor) owes money to a foreign seller (assignor) who keeps his records abroad, and an assignment of the account to an assignee in this state is executed here, subsection (5) makes the Article applicable and makes notification to the account debtor the exclusive method of perfecting the assignment. Where there are points of contact with other states as well as this state, the question whether the relation to this state is “appropriate” is left to judicial decision.

#### NORTH CAROLINA COMMENT

Subsection (1) probably changes the prior North Carolina conflict of laws rule relating to the initial validity of assignments of accounts or contract rights. No cases involving assignments have been found, but, generally, the law of the place where the last act necessary for the creation of the contract took place would govern. *Bundy v. Commercial Credit Corp.*, 200 N.C. 511, 157 S.E. 860 (1931). The Code adopts the rule that the law of the place where the records concerning the accounts are kept will govern both the validity of the assignment and the perfection of the security interest therein. Prior rules regarding the protection of an assignment and the perfection of a security interest in accounts provided that North Carolina law should govern if the transaction out of which the account arose took place in this State, if payment was to be made in this State, or if the account had situs in this State under the normal conflict of laws rules. GS 44-78.

Subsection (2) changes prior law. Under former law, the question would have

#### Cross references:

Sections 1—105, 9—102 and 9—401.

Point 3: Section 9—302.

Point 7: Sections 9—301, 9—312 and 9—402.

#### Definitional cross references:

“Account”. Section 9—106.

“Contract right”. Section 9—106.

“Debtor”. Section 9—105.

“Equipment”. Section 9—109.

“General intangibles”. Section 9—106.

“Goods”. Section 9—105.

“Inventory”. Section 9—109.

“Security interest”. Section 1—201.

been resolved by determining whether or not the goods in question had acquired a situs in this State. See GS 44-38.1.

The North Carolina rules set out in GS 44-38.1 are similar in purpose to subsection (3). However, some changes are effected, the major one being that the Code does not require that the secured party file or register the security interest in this State within ten days after receiving notice that the chattel has been removed to this State and has acquired situs here. See GS 44-38.1 (b) (2). Rather, under the Code, the secured party is protected for the maximum four month period without additional action. Also, the Code does not make registration in the former state a prerequisite to temporary perfection of the security interest in this State as did prior law. GS 44-38.1 (d).

The rules of law relating to the perfection of security interests in motor vehicles brought in from another jurisdiction are virtually identical to the rules of subsection (3). See GS 20-58 (c).

**§ 25-9-104. Transactions excluded from article.**—This article does not apply

(a) to a security interest subject to any statute of the United States such as the Ship Mortgage Act, 1920, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property; or

(b) to a landlord’s lien; or

(c) to a lien given by statute or other rule of law for services or materials except as provided in § 25-9-310 on priority of such liens; or

(d) to a transfer of a claim for wages, salary or other compensation of an employee; or

(e) to an equipment trust covering railway rolling stock; or

(f) to a sale of accounts, contract rights or chattel paper as part of a sale of the business out of which they arose, or an assignment of accounts, contract rights or chattel paper which is for the purpose of collection only, or a transfer of a contract right to an assignee who is also to do the performance under the contract; or

(g) to a transfer of an interest or claim in or under any policy of insurance; or

(h) to a right represented by a judgment; or

(i) to any right of setoff; or

(j) except to the extent that provision is made for fixtures in § 25-9-313, to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder; or

(k) to a transfer in whole or in part of any of the following: any claim arising out of tort; any deposit, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization. (1965, c. 700, § 1.)

**Landlord's Lien Had Priority under Former Agricultural Lien Act.** — See *Brewer v. Chappell*, 101 N.C. 251, 7 S.E. 670 (1888); *Ballard & Co. v. Johnson*, 114 N.C. 141, 19 S.E. 98 (1894); *Williams v.*

*Davis*, 183 N.C. 90, 110 S.E. 577 (1922); *Montague v. Thorpe*, 196 N.C. 163, 144 S.E. 691 (1928); *Rhodes v. Smith-Douglas Fertilizer Co.*, 220 N.C. 21, 16 S.E.2d 408 (1941).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

##### Purposes:

To exclude certain security transactions from this Article.

1. Where a federal statute regulates the incidents of security interests in particular types of property, those security interests are of course governed by the federal statute and excluded from this Article. The Ship Mortgage Act, 1920, is an example of such a federal act. Legislation covering aircraft financing has been proposed to the Congress, and, if enacted, would displace this Article in that field. The present provisions of the Civil Aeronautics Act (49 U.S.C.A. § 523) call for registration of title to and liens upon aircraft with the Civil Aeronautics Administrator and such registration is recognized as equivalent to filing under this Article (Section 9—302(3)); but to the extent that the Civil Aeronautics Act does not regulate the rights of parties to and third parties affected by such transactions, security interests in aircraft remain subject to this Article, pending passage of federal legislation.

Although the Federal Copyright Act contains provisions permitting the mortgage of a copyright and for the recording of an assignment of a copyright (17 U.S.C. §§ 28, 30) such a statute would not seem to contain sufficient provisions regulating the rights of the parties and third parties to exclude security interests in copyrights from the provisions of this Article. Compare *Republic Pictures Corp. v. Security-First National Bank of Los Angeles*, 197 F.2d 767 (9th Cir. 1952). Compare also with respect to patents, 35 U.S.C. § 47. The filing provisions under these Acts, like the filing provisions of the Aeronautics Act, are recognized as the equivalent to filing under this Article. Section 9—302(3).

Even such a statute as the Ship Mortgage Act is far from a comprehensive reg-

ulation of all aspects of ship mortgage financing. That Act contains provisions on formal requisites, on recordation and on foreclosure but not much more. If problems arise under a ship mortgage which are not covered by the Act, the federal admiralty court must decide whether to improvise an answer under "federal law" or to follow the law of some state with which the mortgage transaction has appropriate contacts. The exclusionary language in paragraph (a) is that this Article does not apply to such security interest "to the extent" that the federal statute governs the rights of the parties. Thus if the federal statute contained no relevant provision, this Article could be looked to for an answer.

2. Except for fixtures (Section 9—313), the Article applies only to security interests in personal property. The exclusion of landlord's liens by paragraph (b) and of leases and other interests in or liens on real estate by paragraph (j) merely reiterates the limitations on coverage already made explicit in Section 9—102(3). See Comment 4 to that section.

3. In all jurisdictions liens are given suppliers of many types of services and materials either by statute or by common law. It was thought to be both inappropriate and unnecessary for this Article to attempt a general codification of that lien structure which is in considerable part determined by local conditions and which is far removed from ordinary commercial financing. Paragraph (c) therefore excludes such liens from the Article. Section 9—310 states a rule for determining priorities between such liens and the consensual security interests covered by this Article.

4. In many states assignments of wage claims and the like are regulated by statute. Such assignments present important social problems whose solution should be a matter of local regulation. Paragraph



(d) therefore excludes them from this Article.

5. The exclusion of (e) is made because the persons chiefly interested in railroad equipment trusts have insisted that their rights and obligations are better governed by existing law. Notice that the exclusion applies only to equipment trusts covering railway rolling stock. Equipment trusts on other kinds of property (e. g. trucks, busses, contractors' equipment) are therefore covered by the Article, and so are security arrangements on railway rolling stock which are not equipment trusts. Further, the exclusion of (e) does not affect the question of the extent to which Section 20c of the Interstate Commerce Act (49 U.S.C. § 20c) overrides state law. See exclusion (a), Comment 1 and Section 9.302(3) (a).

6. In general sales as well as security transfers of accounts, contract rights and chattel paper are within the Article (see Section 9—102). Paragraph (f) excludes from the Article certain transfers of such intangibles which, by their nature, have nothing to do with commercial financing transactions.

7. Rights under life insurance and other

policies, and deposit accounts, are often put up as collateral. Such transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law. Paragraphs (g) and (k) make appropriate exclusions.

8. The remaining exclusions go to other types of claims which do not customarily serve as commercial collateral: judgments under paragraph (h), set-offs under paragraph (i) and tort claims under paragraph (k).

#### Cross references:

Point 1: Section 9—302(3).

Point 2: Sections 9—102(3) and 9—313.

Point 3: Sections 9—102(2) and 9—310.

Point 5: Section 9—302(3).

Point 6: Section 9—102.

#### Definitional cross references:

"Account". Section 9—106.

"Bank". Section 1—201.

"Chattel paper". Section 9—105.

"Contract". Section 1—201.

"Contract right". Section 9—106.

"Party". Section 1—201.

"Rights". Section 1—201.

"Security interest". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (b)* preserves the operation and presumably the priority of the landlord's lien, GS 42-15. See *In re Einhorn Bros.*, 171 F. Supp. 655 (E.D. Pa. 1959), *aff'd*, 272 F.2d 434 (3d Cir. 1959).

*Subsection (c)* excludes from the operation of the article the common-law and statutory liens of persons who furnish services and materials. The validity of the following liens recognized by statute in North Carolina is not affected by the Code: Liens of mechanics, laborers and materialmen, GS 44-1 through 44-5; liens on vessels, GS 44-15 through 44-29; liens of hotel keepers and livery stable keepers, GS 44-30 through 44-33. However, the priority of the nonpossessory liens of this class may be changed. See North Carolina Comment to GS 25-9-310.

*Subsection (d)* excludes assignments of wages and statutes regulating those assignments such as GS 95-31.

*Subsection (f)*: Article 9 governs all assignments of accounts or contract rights whether or not made for purposes of acquiring a security interest, except those types of assignments enumerated in subsection (f).

*Subsection (g)* excludes assignments for security or otherwise of any interest or claim under a policy of insurance. Thus, statutes such as GS 58-98 (assignment of policy other than life as collateral security) and 58-32 (insurance as security for loan by the company), remain operable.

*Subsection (j)* makes it clear that whether or not rents from or leases on real property are, by applicable State law, considered as personal property, this article does not apply to security interests therein. GS 47-20.4, which provides for the place of registration of chattels real, continues in effect, as do all other statutes affecting security interests in real property.

**§ 25-9-105. Definitions and index of definitions.** — (1) In this article unless the context otherwise requires:

(a) "Account debtor" means the person who is obligated on an account, chattel paper, contract right or general intangible;

(b) "Chattel paper" means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods. When a transaction is evidenced both by such a security agreement or a lease and by an instru-

ment or a series of instruments, the group of writings taken together constitutes chattel paper;

(c) "Collateral" means the property subject to a security interest, and includes accounts, contract rights and chattel paper which have been sold;

(d) "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts, contract rights or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires;

(e) "Document" means document of title as defined in the general definitions of article 1 (§ 25-1-201);

(f) "Goods" includes all things which are moveable at the time the security interest attaches or which are fixtures (§ 25-9-313), but does not include money, documents, instruments, accounts, chattel paper, general intangibles, contract rights and other things in action. "Goods" also include the unborn young of animals and growing crops;

(g) "Instrument" means a negotiable instrument (defined in § 25-3-104), or a security (defined in § 25-8-102) or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment;

(h) "Security agreement" means an agreement which creates or provides for a security interest;

(i) "Secured party" means a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts, contract rights or chattel paper have been sold. When the holders of obligations issued under an indenture of trust, equipment trust agreement or the like are represented by a trustee or other person, the representative is the secured party.

(2) Other definitions applying to this article and the sections in which they appear are:

"Account." § 25-9-106.

"Consumer goods." § 25-9-109 (1).

"Contract right." § 25-9-106.

"Equipment." § 25-9-109 (2).

"Farm products." § 25-9-109 (3).

"General intangibles." § 25-9-106.

"Inventory." § 25-9-109 (4).

"Lien creditor." § 25-9-301 (3).

"Proceeds." § 25-9-306 (1).

"Purchase money security interest." § 25-9-107.

(3) The following definitions in other articles apply to this article:

"Check." § 25-3-104.

"Contract for sale." § 25-2-106.

"Holder in due course." § 25-3-302.

"Note." § 25-3-104.

"Sale." § 25-2-106.

(4) In addition article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provisions.** Various.

#### **Purposes:**

To state the sense in which certain words are used in this Article.

1. **General.** It is necessary to have a set of terms to describe the parties to a secured transaction, the agreement itself, and the property involved therein; but the selection of the set of terms applicable to

any one of the existing forms (e. g., mortgage and mortgagee) might carry to some extent the implication that the existing law referable to that form was to be used for the construction and interpretation of this Article. Since it is desired to avoid any such implication, a set of terms has been chosen which have no common law or statutory roots tying them to a particular form.

In place of such terms as "chattel mortgage," "conditional sale," "assignment of accounts receivable," "trust receipt," etc., this Article substitutes the general term "security agreement", defined in subsection (1) (h). In place of "mortgagor," "mortgagee," "conditional vendee," "conditional vendor," etc., this Article substitutes "debtor", defined in subsection (1) (d), and "secured party," defined in subsection (1) (i). The property subject to the security agreement is "collateral," defined in subsection (1) (c). The interest in the collateral which is conveyed by the debtor to the secured party is a "security interest", defined in Section 1—201(37).

**2. Parties.** The parties to the security agreement are the "debtor" and the "secured party."

"Debtor": In all but a few cases the person who owes the debt and the person whose property secures the debt will be the same. Occasionally, one person furnishes security for another's debt, and sometimes property is transferred subject to a secured debt of the transferor which the transferee does not assume; in such cases, under the second sentence of the definition, the term "debtor" may, depending upon the context, include either or both such persons. Section 9—112 sets out special rules which are applicable where collateral is owned by a person who does not owe a debt.

"Secured Party": The term includes any person in whose favor there is a security interest (defined in Section 1—201). The term is used equally to refer to a person who as a seller retains a lien on or title to goods sold, to a person whose interest arises initially from a loan transaction, and to an assignee of either. Note that a seller is a "secured party" in relation to his customer; the seller becomes a "debtor" if he assigns the chattel paper as collateral. This is also true of a lender who assigns the debt as collateral. With the exceptions stated on Section 9—104(f) the Article applies to any sale of accounts, contract rights or chattel paper: the term "secured party" includes as assignee of such intangibles whether by sale or for security, to distinguish him from the payee

of the account, for example, who becomes a "debtor" by pledging the account as security for a loan.

"Account Debtor": Where the collateral is an account, contract right, chattel paper or general intangible the original obligor is called the "account debtor", defined in subsection (1) (a).

**3. Property subject to the security agreement.** "Collateral", defined in subsection (1) (c), is a general term of tangible and intangible property subject to a security interest. For some purposes the Code makes distinctions between different types of collateral and therefore further classification of collateral is necessary. Collateral which consists of tangible property is "goods", defined in subsection (1) (f); and "goods" are again subdivided in Section 9—109. For purposes of this Article all intangible collateral fits one of six categories, three of which, "accounts", "contract rights" and "general intangibles", are defined in the following Section 9—106; the other three, "documents", "instruments" and "chattel paper", are defined in subsections (1) (e), (1) (g) and (1) (b) of this Section.

"Goods": The definition in subsection (1) (f) is similar to that contained in Section 2—105 except that the Sales Article definition refers to "time of identification to the contract for sale", while this definition refers to "the time the security interest attaches".

For the treatment of fixtures, Section 9—313 should be consulted. It will be noted that the treatment of fixtures under Section 9—313 does not at all points conform to their treatment under Section 2—107 (goods to be severed from realty). Section 2—107 relates to sale of such goods; Section 9—313 to security interests in them. The discrepancies between the two sections arise from the differences in the types of interest covered.

For the purpose of this Article, goods are classified as "consumer goods", "equipment", "farm products", and "inventory"; those terms are defined in Section 9—109. When the general term "goods" is used in this Article, it includes, as may be appropriate in the context, the subclasses of goods defined in Section 9—109.

"Instrument": The term as defined in subsection (1) (g) includes not only negotiable instruments and investment securities but also any other intangibles evidenced by writings which are in ordinary course of business transferred by delivery. As in the case of chattel paper "delivery" is only the minimum stated and may be accompanied by other steps.



If a writing is itself a security agreement or lease with respect to specific goods it is not an instrument although it otherwise meets the term of the definition. See Comment below on "chattel paper".

"Documents": See the Comment under Section 1—201(15).

"Chattel paper": To secure his own financing a secured party may wish to borrow against or sell the security agreement itself along with his interest in the collateral which he has received from his debtor. Since the refinancing of paper secured by specific goods presents some problems of its own, the term "chattel paper" is used to describe this kind of collateral. The comments under Section 9—308 further describe this concept.

4. The following transactions illustrate the use of the term "chattel paper" and some of the other terms defined in this section.

A dealer sells a tractor to a farmer on conditional sales contract. The conditional sales contract is a "security agreement", the farmer is the "debtor", the dealer is the "secured party" and the tractor is the type of "collateral" defined in Section 9—109 as "equipment". But now the dealer transfers the contract to his bank, either by outright sale or to secure a loan. Since the conditional sales contract is a security agreement relating to specific equipment the conditional sales contract is now the type of collateral called "chattel paper". In this transaction between the dealer and his bank, the bank is the "secured party", the dealer is the "debtor", and the farmer is the "account debtor".

Under the definition of "security interest" in Section 1—201(37) a lease does not

create a security interest unless intended as security. Whether or not the lease itself is a security agreement, it is chattel paper when transferred if it relates to specific goods. Thus, if the dealer enters into a straight lease of the tractor to the farmer (not intended as security), and then arranges to borrow money on the security of the lease, the lease is chattel paper.

Chattel mortgages and conditional sales contracts are frequently executed in connection with a negotiable note or a series of such notes. Under the definitions in subsections (1) (b) and (1) (g) the rules applicable to chattel paper, rather than those relating to instruments, are applicable to the group of writings (contract plus note) taken together.

5. Comments to the definitions indexed in subsections (2) and (3) follow the sections in which the definitions are contained.

#### Cross references:

Point 2: Sections 9—104(f) and 9—112.

Point 3: Sections 2—105, 2—107, 9—106, 9—109, 9—308 and 9—313.

#### Definitional cross references:

"Account". Section 9—106.

"Agreement". Section 1—201.

"Contract right" Section 9—106.

"Document of title". Section 1—201.

"General intangibles". Section 9—106.

"Holder". Section 1—201.

"Money". Section 1—201.

"Negotiable instrument". Section 3—104.

"Person". Section 1—201.

"Representative". Section 1—201.

"Rights". Section 1—201.

"Security". Section 8—102.

"Security interest". Section 1—201.

"Writing". Section 1—201.

#### NORTH CAROLINA COMMENT

This section defines the new terminology which the Code applies to the security interest. The terminology is new,

but the concepts are familiar ones. The definition of "security interest" appears in GS 25-1-201 (37).

**§ 25-9-106. Definitions:** "Account"; "contract right"; "general intangibles."—"Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper. "Contract right" means any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper. "General intangibles" means any personal property (including things in action) other than goods, accounts, contract rights, chattel paper, documents and instruments. (1945, c. 196, s. 1; 1957, c. 504; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

Prior uniform statutory provision: None.

#### Purposes:

The terms defined in this section round out the classification of intangibles: see

the definitions of "document of title" (Section 1—201), "chattel paper" (Section 9—105) and "instrument" (Section 9—105). Those three terms cover the various categories of commercial paper which are

either negotiable or to a greater or less extent dealt with as if negotiable; the closely related terms "account" and "contract right" cover those choses in action which may be the subject of commercial financing transactions but which are not evidenced by an indispensable writing. The term "general intangibles" brings under this Article miscellaneous types of contractual rights and other personal property which are used or may become customarily used as commercial security. Examples are goodwill, literary rights and rights to performance. Other examples are copyrights, trade-marks and patents, except to the extent that they may be excluded by Section 9-104(a). This Article solves the problems of filing of security interests in these types of intangibles (Sections 9-103(2) and 9-401). Note that this catch-all definition does not apply to types of intangibles which are specifically excluded from the coverage of the Article (Section 9-104) and note also that under Section 9-302(2) (a) filing under a federal statute may satisfy the filing requirements of this Article.

"Account" as defined is a right to payment for goods sold or leased or services rendered; that is to say, a right earned by performance, whether or not due and payable, the ordinary commercial account receivable. "Contract right" is a right to be earned by future performance under an ex-

isting contract; for example, rights to arise when deliveries are made under an installment contract or as work is completed under a building contract. Contract rights may be regarded as potential accounts: they become accounts as performance is made under the contract.

It has been found advisable to distinguish rights earned from rights not yet earned for several reasons. The recognition of the "contract right" as collateral in a security transaction makes clear that this Article rejects any lingering common law notion that only rights already earned can be assigned. Furthermore in the triangular arrangement following assignment, there is reason to allow the original parties—assignor and account debtor—more flexibility in modifying the underlying contract before performance than after performance (see Section 9-318). It will, however, be found that in most situations the same rules apply to both accounts and contract rights.

#### Cross references:

Sections 9-103(2), 9-104, 9-302(2) (a), 9-318 and 9-401.

#### Definitional cross references:

"Chattel paper". Section 9-105.

"Contract". Section 1-201.

"Document". Section 9-105.

"Goods". Section 9-105.

"Instrument". Section 9-105.

### NORTH CAROLINA COMMENT

The combined definitions of "account" and "contract right" are substantially the same as the definition of "account receivable" appearing in GS 44-77 (1), except

that the Code definitions do not include contract rights to arise in the future. See GS 25-9-204 and Official Comment 4 thereto.

**§ 25-9-107. Definitions: "Purchase money security interest."**—A security interest is a "purchase money security interest" to the extent that it is

(a) taken or retained by the seller of the collateral to secure all or part of its price; or

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

#### Purposes:

1. Under existing rules of law and under this Article purchase money obligations often have priority over other obligations. Thus a purchase money obligation has priority over an interest acquired under an after-acquired property clause (Section 9-312(3) and (4)); where filing is required a grace period of ten days is allowed against creditors and transferees in bulk (Section 9-301(2)); and in some instances

filing may not be necessary (Section 9-302(1) (c) and (d)).

Under this section a seller has a purchase money security interest if he retains a security interest in the goods; a financing agency has a purchase money security interest when it advances money to the seller, taking back an assignment of chattel paper, and also when it makes advances to the buyer (e. g., on chattel mortgage) to enable him to buy, and he uses the money for that purpose.

2. When a purchase money interest is

claimed by a secured party who is not a seller, he must of course have given present consideration. This section therefore provides that the purchase money party must be one who gives value "by making advances or incurring an obligation": the quoted language excludes from the purchase money category any security interest taken as security for or in satisfaction of a preexisting claim or antecedent debt.

#### Cross references:

Point 1: Sections 9—301, 9—302 and 9—312.

Point 2: Section 9—108.

#### Definitional cross references:

"Collateral". Section 9—105.

"Debtor". Section 9—105.

"Person". Section 1—201.

"Rights". Section 1—201.

"Security interest". Section 1—201.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

This definition of purchase money security interest is substantially in accord with prior North Carolina law. A "purchase money" security interest exists where the seller reserves a security interest in the property for payment of the price, *Goodrich Silvertown Stores v. Caeser*, 214 N.C. 85, 197 S.E. 698 (1938), or where a person advances money for the purchase and takes a mortgage or deed of trust on the

property as security for his advances. *Smith Builders Supply, Inc. v. Rivenbark*, 231 N.C. 213, 56 S.E.2d 431 (1949); *Weil v. Casey*, 125 N.C. 356, 34 S.E. 506 (1899). The latter two cases involved security interests in real property, but the same principle should apply to personal property.

For the applicability of this section of the Code, see the North Carolina Comments to GS 25-9-301, 25-9-302, 25-9-312.

**§ 25-9-108. When after-acquired collateral not security for antecedent debt.** — Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

#### Purposes:

1. Many financing transactions contemplate that the collateral will include both the debtor's existing assets and also assets thereafter acquired by him in the operation of his business. This Article generally validates such after-acquired property interests (see Section 9—204 and Comment) although they may be subordinated to later purchase money interests under Section 9—312(3) and (4).

Interests in after-acquired property have never been considered as involving transfers of property for antecedent debt merely because of the after-acquired feature, nor should they be so considered. The section makes explicit what has been true under the case law: an after-acquired property interest is not, by virtue of that fact alone, security for a pre-existing claim. This rule is of importance principally in insolvency proceedings under the federal Bankruptcy Act or state statutes which make certain transfers for antecedent debt voidable as preferences. The determination of when a transfer is for ante-

cedent debt is largely left by the Bankruptcy Act to state law.

Two tests must be met under this section for an interest in after-acquired property to be one not taken for an antecedent debt. *First:* the secured party must, at the inception of the transaction, have given new value in some form. *Second:* the after-acquired property must come in either in the ordinary course of the debtor's business or as an acquisition which is made under a contract of purchase entered into within a reasonable time after the giving of new value and pursuant to the security agreement. The reason for the first test needs no comment. The second is in line with limitations which judicial construction has placed on the operation of after-acquired property clauses. Their coverage has been in many cases restricted to subsequent ordinary course acquisitions: this Article does not go so far (see Section 9—204 and Comment), but it does deny present value status to out of ordinary course acquisitions not made pursuant to the original loan agreement. This solution gives the



secured party full protection as to the collateral which he may be reasonably thought to have contracted for; it gives other creditors the possibility, under the law of preferences, of subjecting to their claims windfall or unanticipated acquisitions shortly before bankruptcy.

2. The term "value" is defined in Section 1—201(44) and discussed in the accompanying Comment. In this section and in other sections of this Article the term "new value" is used but is left without statutory definition. The several illustrations of "new value" given in the text of this section (making an advance, incurring an obligation, releasing a perfected security interest) as well as the "purchase money security interest" definition in Sec-

tion 9—107 indicate the nature of the concept. In other situations it is left to the courts to distinguish between "new" and "old" value, between present considerations and antecedent debt.

**Cross references:**

Point 1: Sections 9—204 and 9—312.

Point 2: Section 9—107.

**Definitional cross references:**

"Collateral". Section 9—105.

"Contract". Section 1—201.

"Debtor". Section 9—105.

"Purchase". Section 1—201.

"Rights". Section 1—201.

"Secured party". Section 9—105.

"Security agreement". Section 9—105.

"Security interest". Section 1—201.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

This section sets out the conditions under which the acquisition of a security interest in subsequently acquired property by virtue of an "after-acquired" provision in a preceding security agreement will be for new value. The section is primarily of importance in determining whether the acquisition of the security interest in the after-acquired property will be deemed a transfer for an antecedent debt under the Federal Bankruptcy Act § 60 and State statutes governing preferences such as GS 23-3. Although no cases have been found which are precisely in point with this section, there are indications that this section will not change the approach of the North Carolina court. In *Godwin v. Murchison Nat'l Bank*, 145 N.C. 320, 59 S.E. 154 (1907), a debtor, more than four months before bankruptcy, promised a bank that he would pledge certain property as se-

curity for a loan. The debtor did not own the property at the time, but subsequently, within four months of bankruptcy, he acquired ownership and delivered the property to the bank. The court held that the transfer of the property was not for an antecedent debt on the theory that he had made an equitable assignment of the property at the time he borrowed the money. Probably, the same reasoning could, under former law, have been applied to a chattel mortgage with an after-acquired property clause to achieve a result similar to that intended with this section of the Code.

Whether this section will uniformly achieve its intended effect under the Federal Bankruptcy Act remains to be seen. See generally, Coogan, Hogan and Vagts, *Secured Transactions under UCC 1172* (1963).

**§ 25-9-109. Classification of goods; "consumer goods"; "equipment"; "farm products"; "inventory."**—Goods are

(1) "consumer goods" if they are used or bought for use primarily for personal, family or household purposes;

(2) "equipment" if they are used or bought for use primarily in business (including farming or a profession) or by a debtor who is a nonprofit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods;

(3) "farm products" if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory;

(4) "inventory" if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment. (1965, c. 700, s. 1.)

## OFFICIAL COMMENT

Prior uniform statutory provision: None.

## Purposes:

1. This section classifies goods as consumer goods, equipment, farm products and inventory. The classification is important in many situations: it is relevant, for example, in determining the rights of persons who buy from a debtor goods subject to a security interest (Section 9—307), in certain questions of priority (Section 9—312), in determining the place of filing (Section 9—401) and in working out rights after default (Part 5). Comment 5 to Section 9—102 contains an index of the special rules applicable to different classes of collateral.

2. The classes of goods are mutually exclusive; the same property cannot at the same time and as to the same person be both equipment and inventory, for example. In borderline cases—a physician's car or a farmer's jeep which might be either consumer goods or equipment—the principal use to which the property is put should be considered as determinative. Goods can fall into different classes at different times; a radio is inventory in the hands of a dealer and consumer goods in the hands of a householder.

3. The principal test to determine whether goods are inventory is that they are held for immediate or ultimate sale. Implicit in the definition is the criterion that the prospective sale is in the ordinary course of business. Machinery used in manufacturing, for example, is equipment and not inventory even though it is the continuing policy of the enterprise to sell machinery when it becomes obsolete. Goods to be furnished under a contract of service are inventory even though the arrangement under which they are furnished is not technically a sale. When an enterprise is engaged in the business of leasing a stock of products to users (for example, the fleet of cars owned by a car rental agency), that stock is also included within the definition of "inventory". It should be noted that one class of goods which is not held for disposition to a purchaser or user is included in inventory: "Materials used or consumed in a business". Examples of this class of inventory are fuel to be used in operations, scrap metal produced in the course of manufacture, and containers to be used to package the goods. In general it may be said that goods used in a business are equipment when they are fixed assets or have, as identifiable units, a relatively long period of use; but are inventory, even though not held for sale, if they

are used up or consumed in a short period of time in the production of some end product.

4. Goods are "farm products" only if they are in the possession of a debtor engaged in farming operations. Animals in a herd of livestock are covered whether they are acquired by purchase or result from natural increase. Products or crops or livestock remain farm products so long as they are in the possession of a debtor engaged in farming operations and have not been subjected to a manufacturing process. The terms "crops", "livestock" and "farming operations" are not defined; however, it is obvious from the text that "farming operations" includes raising livestock as well as crops; similarly, since eggs are products of livestock, livestock includes fowl.

When crops or livestock or their products come into the possession of a person not engaged in farming operations they cease to be "farm products". If they come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials, they become inventory.

Products of crops or livestock, even though they remain in the possession of a person engaged in farming operations, lose their status as farm products if they are subjected to a manufacturing process. What is and what is not a manufacturing operation is not determined by this Article. At one end of the scale some processes are so closely connected with farming—such as pasteurizing milk or boiling sap to produce maple syrup or maple sugar—that they would not rank as manufacturing. On the other hand an extensive canning operation would be manufacturing. The line is one for the courts to draw. After farm products have been subjected to a manufacturing operation, they become inventory if held for sale.

Note that the buyer in ordinary course who under Section 9—307 takes free of a security interest in goods held for sale does not include one who buys farm products from a person engaged in farming operations.

5. The principal definition of equipment is a negative one: goods used in a business (including farming or a profession) which are not inventory and not farm products. Trucks, rolling stock, tools, machinery are typical. It will be noted furthermore that any goods which are not covered by one of the other definitions in this section are to be treated as equipment.

**Cross references:**

Point 1: Sections 9—102, 9—307, 9—312, 9—401 and Part 5.

Point 3: Section 9—307.

Point 4: Section 9—307.

**Definitional cross references:**

“Contract”. Section 1—201.

“Debtor”. Section 9—105.

“Goods”. Section 9—105.

“Organization”. Section 1—201.

“Person”. Section 1—201.

“Sale”. Sections 2—106 and 9—105.

**NORTH CAROLINA COMMENT**

This section is new and has no counterpart in prior North Carolina law. The classification of the goods to be subject to the security interest is the starting point for determination of many factors con-

cerning the security interest, e.g., the steps necessary for the perfection of the security interest, GS 25-9-302, and others mentioned in the Official Comment to this section.

§ 25-9-110. **Sufficiency of description.**—For the purposes of this article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described. (1965, c. 700, s. 1.)

**Land Descriptions Held Sufficient for Agricultural Liens.** — The land on which the crops are to be grown must be sufficiently identified at the time the lien is executed. Within this ruling, land is sufficiently identified when described as “a field or farm in possession of the mortgagor or seller.” *Weil v. Flowers*, 109 N.C. 212, 13 S.E. 761 (1891). See *Gwathney v. Etheridge*, 99 N.C. 571, 6 S.E. 411 (1888).

An instrument giving a lien upon crops

raised “upon Opossum Quarter tract of land in Warren County, known as the tract M. W. is buying from Egerton, or any other lands he may cultivate during the present year,” sufficiently described the lands upon which the crops were to be raised, and was effective as to the crops raised on the land described, but void as to those raised on “any other lands.” *Crinkley v. Egerton*, 113 N.C. 142, 18 S.E. 341 (1893).

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

The requirement of description of collateral (see Section 9—203 and Comment thereto) is evidentiary. The test of sufficiency of a description laid down by this Section is that the description do the job assigned to it—that it make possible the identification of the thing described. Under this rule courts should refuse to fol-

low the holdings, often found in the older chattel mortgage cases, that descriptions are insufficient unless they are of the most exact and detailed nature, the so-called “serial number” test. The same test of reasonable identification applies where a description of real estate is required in a financing statement. See Section 9—402.

**Cross references:**

Sections 9—203 and 9—402.

**NORTH CAROLINA COMMENT**

This section is substantially in accord with prior North Carolina law. Implicit in the North Carolina decisions is the rule that any description which reasonably identifies the property so that it can be segregated from other property of a like kind owned by the debtor is sufficient. *Forehand v. Edentown Farmers' Co.*, 206 N.C. 827, 175 S.E. 183 (1934) (dictum); *Strouse v. Cohen*, 113 N.C. 349, 18 S.E. 323 (1893) (“all my property located in the city of New Bern” is a sufficient description).

The North Carolina court has not followed the strict “serial number” test which this section of the Code is designed to replace. See *Peek v. Wachovia Bank &*

*Trust Co.*, 242 N.C. 1, 86 S.E.2d 745 (1955); *Twin City Motor Co. v. Rouzer Motor Co.*, 197 N.C. 371, 148 S.E. 461 (1929) (“one S.H. Coupe No. ——— Model T” is sufficient).

Likewise, where a security interest in personal property must refer to certain real property, as in the case of crop liens, a full legal description of the real property is not required. A description which reasonably enables an interested party to ascertain which property is included in the security agreement is sufficient. *Hurley v. Ray*, 160 N.C. 376, 76 S.E. 234 (1912) (by implication); *Woodlief v. Harris*, 95 N.C. 211 (1886) (“all crops raised on lands owned or rented by me” is sufficient).



§ 25-9-111. **Applicability of bulk transfer laws.**—The creation of a security interest is not a bulk transfer under article 6 (see § 25-6-103). (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

The bulk transfer laws, which have been almost everywhere enacted, were designed to prevent a once prevalent type of fraud which seems to have flourished particularly in the retail field: the owner of a debt-burdened enterprise would sell it to an unwary purchaser and then remove himself, with the purchase price and his other assets, beyond the reach of process. The creditors would find themselves with no recourse unless they could establish that the purchaser assumed existing debts. The bulk transfer laws, which require advance notice of sale to all known creditors, seem to have been successful in preventing such frauds.

There has been disagreement whether the bulk transfer laws should be applied to security as well as to sale transactions. In most states security transactions have not been covered; in a few states the opposite result has been reached either by judicial construction or by express

statutory provision. Whatever the reasons may be, it seems to be true that the bulk transfer type of fraud has not often made its appearance in the security field: it may be that lenders of money are more inclined to investigate a potential borrower than are purchasers of retail stores to determine the true state of their vendor's affairs. Since compliance with the bulk transfer laws is onerous and expensive, legitimate financing transactions should not be required to comply when there is no reason to believe that other creditors will be prejudiced.

This section merely reiterates the provisions of Article 6 on Bulk Transfers which provide in Section 6—103(1) that transfers “made to give security for the performance of an obligation” are not subject to that Article.

**Cross reference:**

Section 6—103(1).

**Definitional cross reference:**

“Security interest”. Section 1—201.

#### NORTH CAROLINA COMMENT

GS 39-23 provided: “The sale in bulk of a large part or the whole of a stock of merchandise, otherwise than in the ordinary course of trade . . . shall be void as against the creditors of the seller, unless the seller” complies with the conditions. The problem presented in determining whether this section of the UCC will change prior North Carolina law is defining the word “sale” as it appeared in the statute.

A majority of jurisdictions have held that the execution of a chattel mortgage on a stock of merchandise is not a transfer within the purview of the Bulk Sales Law where the statute does not specifically so provide. See, e.g., *Mackler v. Lahman*, 196 Ga. 535, 27 S.E.2d 35 (1943); *Cozzi v.*

*Pizzo*, 337 Ill. App. 384, 86 N.E.2d 294 (1949); *Schwartz v. King Realty & Inv. Co.*, 94 N.J.L. 134, 109 Atl. 567 (1920).

The North Carolina court has apparently held that the execution of trust receipts for a contemporaneous new consideration does not fall within the Bulk Sales Law. *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960) (semble). If the security had been given for a past consideration, the court indicated that the result would have been different. See also *Cowan v. Dale*, 189 N.C. 684, 128 S.E. 155 (1925). The UCC does not make such a distinction and to that extent probably changes North Carolina law.

§ 25-9-112. **Where collateral is not owned by debtor.**—Unless otherwise agreed, when a secured party knows that collateral is owned by a person who is not the debtor, the owner of the collateral is entitled to receive from the secured party any surplus under § 25-9-502 (2) or under § 25-9-504 (1), and is not liable for the debt or for any deficiency after resale, and he has the same right as the debtor

- (a) to receive statements under § 25-9-208;
- (b) to receive notice of and to object to a secured party's proposal to retain the collateral in satisfaction of the indebtedness under § 25-9-505;
- (c) to redeem the collateral under § 25-9-506;
- (d) to obtain injunctive or other relief under § 25-9-507 (1); and
- (e) to recover losses caused to him under § 25-9-208 (2). (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

Under the definition of Section 9-105, in any provisions of the Article dealing with the collateral the term "debtor" means the owner of the collateral even though he is not the person who owes payment or performance of the obligation secured. This section covers several situations in which the implications of this definition are specifically set out.

The duties which this section imposes on a secured party toward such an owner of collateral are conditioned on the secured party's knowledge of the true state of facts. Short of such knowledge he may continue to deal exclusively with the person who owes the obligation. Nor does the section suggest that the secured party is under any duty of inquiry. It does not purport to cut across the law of conversion or of ultra vires. Whether a person who does not own property has

authority to encumber it for his own debts and whether a person is free to encumber his property as collateral for the debts of another, are matters to be decided under other rules of law and are not covered by this section.

The section does not purport to be an exhaustive treatment of the subject. It isolates certain problems which may be expected to arise and states rules as to them. Others will no doubt arise: their solution is left to the courts.

**Cross references:**

Sections 9-105, 9-208 and Part 5.

**Definitional cross references:**

"Collateral". Section 9-105.

"Debtor". Section 9-105.

"Notice". Section 1-201.

"Person". Section 1-201.

"Receive notice". Section 1-201.

"Right". Section 1-201.

"Secured party". Section 9-105.

**NORTH CAROLINA COMMENT**

There were no comparable provisions in prior North Carolina law.

§ 25-9-113. **Security interests arising under article on sales.**—A security interest arising solely under the article on sales (article 2) is subject to the provisions of this article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods

(a) no security agreement is necessary to make the security interest enforceable; and

(b) no filing is required to perfect the security interest; and

(c) the rights of the secured party on default by the debtor are governed by the article on sales (article 2). (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. Under the provisions of Article 2 on Sales, a seller of goods may reserve a security interest (see, e. g., Sections 2-401 and 2-505); and in certain circumstances, whether or not a security interest is reserved, the seller has rights of resale and stoppage under Sections 2-703, 2-705 and 2-706 which are similar to the rights of a secured party. Similarly, under such sections as Sections 2-506, 2-707 and 2-711, a financing agency, an agent, a buyer or another person may have a security interest or other right in goods similar to that of a seller. The use of the term "security interest" in the Sales Article is meant to bring the interests so designated within this Article. This section makes it clear, however, that such security interests are

exempted from certain provisions of this Article. Compare Section 4-208(3), making similar special provisions for security interests arising in the bank collection process.

2. The security interests to which this section applies commonly arise by operation of law in the course of a sale transaction. Since the circumstances under which they arise are defined in the Sales Article, there is no need for the "security agreement" defined in Section 9-105 (1) (h) and required by Sections 9-203 (1) (b) and 9-204(1), and paragraph (a) dispenses with such requirements. The requirement of filing may be inapplicable under Sections 9-302(1) (a) and (b), 9-304 and 9-305, where the goods are in the possession of the secured party or of a bailee other than the debtor. To avoid difficulty in the residual cases, as

for example where a bailee does not receive notification of the secured party's interest until after the security interest arises, paragraph (b) dispenses with any filing requirement. Finally, paragraph (c) makes inapplicable the default provisions of Part 5 of this Article, since the Sales Article contains detailed provisions governing stoppage of delivery and resale after breach. See Sections 2-705, 2-706, 2-707(2) and 2-711(3).

3. These limitations on the applicability of this Article to security interests arising under the Sales Article are appropriate only so long as the debtor does not have or lawfully obtain possession of the goods. Compare Section 56(b) of the Uniform Sales Act. A secured party who wishes to retain a security interest after the debtor lawfully obtains possession must comply fully with all the provisions of this Article and ordinarily must file a financing statement to perfect his interest. This is the effect of the "except" clause in the preamble to this section. Note that in the case of a buyer who has a security interest in rejected goods under Section 2-711(3), the buyer is the "secured party" and the seller is the "debtor".

4. This section applies only to a "security interest". The definition of "security interest" in Section 1-201(37) expressly excludes the special property interest of a buyer of goods on identification under Section 2-401(1). The seller's interest after identification and before delivery may be more than a security interest by virtue of explicit agreement under Section 2-401(1) or 2-501(1), by virtue of the provisions of Section 2-401(2), (3)

or (4), or by virtue of substitution pursuant to Section 2-501(2). In such cases, Article 9 is inapplicable by the terms of Section 9-102(1) (a).

5. Where there is a "security interest", this section applies only if the security interest arises "solely" under the Sales Article. Thus Section 1-201(37) permits a buyer to acquire by agreement a security interest in goods not in his possession or control; such a security interest does not impair his rights under the Sales Article, but any rights based on the security agreement are fully subject to this Article without regard to the limitations of this section. Similarly, a seller who reserves a security interest by agreement does not lose his rights under the Sales Article, but rights other than those conferred by the Sales Article depend on full compliance with this Article.

#### Cross references:

Point 1: Sections 2-401, 2-505, 2-506, 2-705, 2-706, 2-707, 2-711(3), 4-208(3).

Point 2: Sections 2-705, 2-706, 2-707(2), 2-711(3), 9-203(1) (b), 9-204(1), 9-302(1) (a) and (b), 9-304, 9-305 and Part 5.

Point 3: Section 2-711(3).

Point 4: Sections 2-401, 2-501 and 9-102(1) (a).

#### Definitional cross references:

"Debtor". Section 9-105.

"Goods". Section 9-105.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

### NORTH CAROLINA COMMENT

See North Carolina Comments to article 2, GS 25-2-326, 25-2-401 and 25-2-502.

## PART 2.

### VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO.

**§ 25-9-201. General validity of security agreement.**—Except as otherwise provided by this chapter a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. Nothing in this article validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail installment sales, or the like, or extends the application of any such statute or regulation to any transaction not otherwise subject thereto. (1961, c. 574; 1965, c. 700, s. 1.)

**Compliance with Statute Was Necessary to Sustain Agricultural Lien.**—See *Clark v. Farrar*, 74 N.C. 686 (1876); *Reese & Co. v. Cole*, 93 N.C. 87 (1885).

**Instrument May Give Remedy Different from Statute.**—A power of sale upon de-

fault in paying advances, inserted in an instrument, giving a lien upon crops, does not invalidate the instrument, though prescribing a different remedy from that allowed by the statute. *Crinkley v. Egerton*, 113 N.C. 142, 18 S.E. 341 (1893).



**Instrument Held Valid Both as Chattel Mortgage and Agricultural Lien.** — See

*Nichols & Bros. v. Speller*, 120 N.C. 75, 26 S.E. 632 (1897).

### OFFICIAL COMMENT

**Prior uniform statutory provisions:** Section 4, Uniform Conditional Sales Act; Section 3, Uniform Trust Receipts Act.

**Changes:** Rewritten; no change in substance.

#### Purposes of changes:

This section states the general validity of a security agreement. In general the security agreement is effective between the parties; it is likewise effective against third parties. Exceptions to this general rule arise where there is a specific provision in any Article of this Act, for example, where Article 1 invalidates a disclaimer of the obligations of good faith, etc. (Section 1-102(3)), or this Article subordinates the security interest because it has not been perfected (Section 9-301) or for other reasons (see Section 9-312 on priorities) or defeats the security interest where certain types of claimants

are involved (for example Section 9-307 on buyers of goods). As pointed out in the Note to Section 9-102, there is no intention that the enactment of this Article should repeal retail installment selling acts or small loan acts. Nor of course are the usury laws of any state repealed. These are mentioned in the text of Section 9-201 as examples of applicable laws, outside this Code entirely, which might invalidate the terms of a security agreement.

#### Cross references:

Sections 1-102(3), 9-301, 9-307 and 9-312.

#### Definitional cross references:

"Collateral". Section 9-105.

"Creditor". Section 1-201.

"Party". Section 1-201.

"Purchaser". Section 1-201.

"Security agreement". Section 9-105.

### NORTH CAROLINA COMMENT

The first sentence of this section states the basic freedom of contract rule; that is, the parties may enter into any agreement they choose, and it will be enforceable unless otherwise provided by the Code or other regulatory statute. The principle is implicit in North Carolina cases, e.g., *Rea v. Universal C.I.T. Credit Corp.*, 257 N.C. 639, 127 S.E.2d 225 (1962).

The second sentence re-emphasizes the continuing validity and operation of prior regulatory statutes which may affect security interests, such as Consumer Finance Act, GS 53-164 through 53-190, laws relating to usury, GS 24-1 and 24-2, and laws relating to the regulation of pawnbrokers, GS 91-1 through 91-8.

§ 25-9-202. **Title to collateral immaterial.**—Each provision of this article with regards to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

#### Purposes:

The rights and duties of the parties to a security transaction and of third parties are stated in this Article without reference to the location of "title" to the collateral. Thus the incidents of a security interest which secures the purchase price of goods are the same under this Article whether the secured party appears to have retained title or the debtor appears to have obtained title and then conveyed it or a lien to the secured party. This Article in no way determines which line of interpretation (title theory v. lien theory or retained title v. conveyed title) should be followed in cases where the applicability of some other rule of law depends upon who has title. Thus if a revenue law imposes a tax on the "legal" owner of goods or if a corporation law

makes a vote of the stockholders prerequisite to a corporation "giving" a security interest but not if it acquires property "subject" to a security interest, this Article does not attempt to define whether the secured party is a "legal" owner or whether the transaction "gives" a security interest for the purpose of such laws. Other rules of law or the agreement of the parties determine the location of "title" for such purposes.

Petitions for reclamation brought by a secured party in his debtor's insolvency proceedings have often been granted or denied on a title theory: where the secured party has title, reclamation will be granted; where he has "merely a lien", reclamation may be denied. For the treatment of such petitions under this Article, see Point 1 of Comment to Section 9-507.

**Cross references:**

Sections 2—401 and 2—507.

**Definitional cross references:**

"Collateral". Section 9—105.

"Debtor". Section 9—105.

"Remedy". Section 1—201.

"Rights". Section 1—201.

"Secured party". Section 9—105.

**NORTH CAROLINA COMMENT**

This section does not make any significant change in the approach of the North Carolina law. The traditional distinctions between chattel mortgages and conditional sales contracts required ascertainment of location of title before and after the completion of the transaction resulting in detailed, and often times difficult, rules. However, there are so few situations in which the consequences of chattel mortgages and conditional sales contracts would differ in North Carolina that the court has seldom faced the problem where its solution would make any difference. "The relationship between . . . (the parties) . . . with respect to said automobile, by virtue of the contract which provides that the title to the automobile is retained by the plaintiff . . . until . . . the purchase price has been paid in full, is that of mortgagee and mortgagor; the title-retaining contract is to all intents and purposes a chattel mortgage." *Harris v. Seaboard Airline Ry.*, 190 N.C. 480, 130 S.E. 319 (1925). See also *McCreary Tire & Rubber*

*Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960) ("conditional sales contracts for personalty are treated as chattel mortgages in this jurisdiction"); *Mitchell v. Battle*, 231 N.C. 68, 55 S.E.2d 803 (1949); *Hackley Piano Co. v. Kennedy*, 152 N.C. 196, 67 S.E. 488 (1910).

However, the Official Comment states that this section does not mean that title will never be significant. For tax, or other, purposes it may be necessary to determine the location of title, and the Code takes no position on the theory used for such purposes. Also, the North Carolina court has held that the finance charges under conditional sales contracts are not subject to usury laws, whereas the interest charged for a loan secured by a chattel mortgage would be. *Hendrix v. Harry's Cadillac Co.*, 220 N.C. 84, 16 S.E.2d 456 (1941). In such a case under the Code, the court would have to determine location of title in order to determine if the security interest is in the nature of a conditional sale.

**§ 25-9-203. Enforceability of security interest; proceeds; formal requisites.**—(1) Subject to the provisions of § 25-4-208 on the security interest of a collecting bank and § 25-9-113 on a security interest arising under the article on sales, a security interest is not enforceable against the debtor or third parties unless

(a) the collateral is in the possession of the secured party; or

(b) the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut, a description of the land concerned. In describing collateral, the word "proceeds" is sufficient without further description to cover proceeds of any character.

(2) A transaction, although subject to this article, is also subject to the North Carolina Consumer Finance Act, being G.S. 53-164 through G.S. 53-191, and G.S. 24-1, G.S. 24-2, and G.S. 91-1 through G.S. 91-8, and in the case of conflict between the provisions of this article and any such statute, the provisions of such statute control. Failure to comply with any applicable statute has only the effect which is specified therein. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C. S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 2; c. 196, s. 2; 1955, c. 386, s. 1; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1.)

**No Particular Form of Agricultural Lien Was Required.** — See *Meekins v. Walker*, 119 N.C. 46, 25 S.E. 706 (1896);

*Jones-Phillips Co. v. McCormick*, 174 N.C. 82, 93 S.E. 449 (1917).

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 2, Uniform Trust Receipts Act.

**Changes:** Adapted to fit the scheme of this Article.

**Purposes of changes:**

1. Here as elsewhere in this Article, following the policy of the Uniform Trust Receipts Act, formal requisites are re-

duced to a minimum. The technical requirements of acknowledgment, accompanying affidavits, etc., common to much chattel mortgage legislation, are abandoned. The only requirements for the enforceability of non-possessory security interests in cases not involving land are (a) a writing; (b) the debtor's signature; and (c) a description of the collateral or kinds of collateral. (Typically, of course, the agreement will contain much more.) As to the type of description which will satisfy the requirements of this section, see Section 9-110 and Comment thereto.

2. In the case of crops, or timber growing on land, or of gas or oil or minerals to be extracted, the best identification is by describing the land and subsection (1) (b) requires such a description.

3. One purpose of the formal requisites stated in subsection (1) (b) is evidentiary. The requirement of written record minimizes the possibility of future dispute as to the terms of a security agreement and as to what property stands as collateral for the obligation secured. Where the collateral is in the possession of the secured party, the evidentiary need for a written record is much less than where the collateral is in the debtor's possession; customarily, of course, as a matter of business practice the written record will be kept, but, in this Article as at common law, the writing is not a formal requisite. Subsection (1) (a), therefore, dispenses with the written agreement—and thus with signature and description—if the collateral is in the secured party's possession.

4. The definition of "security agreement" (Section 9-105) is "an agreement which creates or provides for a security interest". Under that definition the requirement of this section that the debtor sign a security agreement is not intended to reject, and does not reject, the deeply rooted doctrine that a bill of sale although absolute in form may be shown to have been in fact given as security. Under this Article as under prior law a debtor may show by parol evidence that a transfer purporting to be absolute was in fact for security and may then, on payment of the debt, assert his fundamental right to return of the collateral and execution of an acknowledgment of satisfaction.

5. The formal requisites stated in this section are not only conditions to the

enforceability of a security interest against third parties. They are in the nature of a Statute of Frauds. Unless the secured party is in possession of the collateral, his security interest, absent a writing which satisfies subsection (1) (b), is not enforceable even against the debtor, and cannot be made so on any theory of equitable mortgage or the like. If he has advanced money, he is of course a creditor and, like any creditor, is entitled after judgment to appropriate process to enforce his claim against his debtor's assets; he will not, however, have against his debtor the rights given a secured party by Part 5 of this Article on Default. The theory of equitable mortgage, insofar as it has operated to allow creditors to enforce informal security agreements against debtors, may well have developed as a necessary escape from the elaborate requirements of execution, acknowledgment and the like which the nineteenth century chattel mortgage acts vainly relied on as a deterrent to fraud. Since this Article reduces formal requisites to a minimum, the doctrine is no longer necessary or useful. More harm than good would result from allowing creditors to establish a secured status by parol evidence after they have neglected the simple formality of obtaining a signed writing.

6. Subsection (2) states that the provisions of regulatory statutes covering the field of consumer finance prevail over the provisions of this Article in case of conflict. The second sentence of the subsection is added to make clear that no doctrine of total voidness for illegality is intended: failure to comply with the applicable regulatory statute has whatever effect may be specified in that statute, but no more.

#### Cross references:

Sections 4-208 and 9-113.

Point 1: Section 9-110.

Point 5: Part 5.

#### Definitional cross references:

"Collateral". Section 9-105.

"Debtor". Section 9-105.

"Party". Section 1-201.

"Proceeds". Section 9-306.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Signed". Section 1-201.

### NORTH CAROLINA COMMENT

Subsection (1) (b) in effect establishes a statute of frauds for security agreements. This would change prior law relating to

chattel mortgages and conditional sales. As between the original parties, oral chattel mortgages or conditional sales were



valid and enforceable. *Kearns v. Davis Bros.*, 186 N.C. 522, 120 S.E. 52 (1923); *Odom v. Clark*, 146 N.C. 544, 60 S.E. 513 (1908); *Butts v. Screws*, 95 N.C. 215 (1886). However, the security agreement had to be reduced to writing for registration and hence protection from the intervention of third parties' rights. Thus, the change is of minimal commercial significance.

Prior law required that a security interest which was procured by way of a lien on crops for advances, a factor's lien, or

a trust receipt had to be reduced to writing to be enforceable. GS 44-52, 44-70, 45-47.

Subsection (1) (a) recognizes the validity of security interest where the secured party has possession of the goods even though there be no written evidence thereof. This is in accord with prior law.

See the North Carolina Comment to GS 25-9-110, which relates to the description of property which will be sufficient to satisfy this section.

**§ 25-9-204. When security interest attaches; after-acquired property; future advances.**—(1) A security interest cannot attach until there is agreement (subsection (3) of § 25-1-201) that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

(2) For the purposes of this section the debtor has no rights

(a) in crops until they are planted or otherwise become growing crops, in the young of livestock until they are conceived;

(b) in fish until caught, in oil, gas or minerals until they are extracted, in timber until it is cut;

(c) in a contract right until the contract has been made;

(d) in an account until it comes into existence.

(3) Except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.

(4) No security interest attaches under an after-acquired property clause

(a) to crops which become such more than one year after the security agreement is executed except that a security interest in crops which is given in conjunction with a lease or a land purchase or improvement transaction evidenced by a contract, mortgage or deed of trust may if so agreed attach to crops to be grown on the land concerned during the period of such real estate transaction;

(b) to consumer goods other than accessions (§ 25-9-314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.

(5) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C. S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 2; c. 196, s. 1; 1955, c. 386, s. 1; c. 816; 1957, cc. 504, 999; 1965, c. 700, s. 1.)

#### **Execution of Agreement and Furnishing of Supplies Treated as Contemporaneous.**

—When furnishing the supplies and making the securing instruments were contemporaneous, constituting one transaction of which these acts were parts, it was not material which preceded in actual time, for in contemplation of law both were done at one and the same time. This view was suggested in *Womble v. Leach*, 83 N.C. 84 (1880), as a reasonable construction

which accomplished the substantial purposes intended. *Reese & Co. v. Cole*, 93 N.C. 87 (1885).

**Crops Covered by Lien.** — The operations of a mortgage or agricultural lien in respect to crops were confined to crops then or about to be planted, and did not extend further than those planted next after the execution of the instrument. *Wooten v. Hill*, 98 N.C. 48, 3 S.E. 846 (1887).

#### **OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.  
**Purposes:**

1. Subsection (1) states three basic prerequisites to the existence of a security

interest: agreement, value, and collateral. When these three coexist a security interest may, in the terminology adopted in this Article, attach. Perfection of a security interest will in many cases depend on the additional step of filing a financing statement (see Section 9—302); Section 9—301 states who will take priority over a security interest which has attached but which has not been perfected. The second sentence of the subsection states a rule of construction under which the security interest, unless postponed by explicit agreement, attaches automatically when the three stated events have occurred.

2. Subsections (1) and (3) read together make clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement. (To this general rule subsection (4) states two exceptions.) That is to say: the security interest in after-acquired property is not merely an “equitable” interest; no further action by the secured party—such as the taking of a supplemental agreement covering the new collateral—is required. This does not however mean that the interest is proof against subordination or defeat: Section 9—108 should be consulted on when a security interest in after-acquired collateral is not security for antecedent debt, and Section 9—312(3) and (4) on when such a security interest may be subordinated to a conflicting purchase money security interest in the same collateral.

3. This Article accepts the principle of a “continuing general lien” which is stated in Section 45 of the New York Personal Property Law and other similar statutes applicable to “factor’s lien”. It rejects the doctrine—of which the judicial attitude toward after-acquired property interests was one expression—that there is reason to invalidate as a matter of law what has been variously called the floating charge, the free-handed mortgage and the lien on a shifting stock. This Article validates a security interest in the debtor’s existing and future assets, even though (see Section 9—205) the debtor has liberty to use or dispose of collateral without being required to account for proceeds or substitute new collateral. (See further, however, Section 9—305 on Proceeds and Comment thereto.)

The widespread nineteenth century prejudice against the floating charge was based on a feeling, often inarticulate in

the opinions, that a commercial borrower should not be allowed to encumber all his assets present and future, and that for the protection not only of the borrower but of his other creditors a cushion of free assets should be preserved. That inarticulate premise has much to recommend it. This Article decisively rejects it not on the ground that it was wrong in policy but on the ground that it has not been effective. In the past fifty years there has been a multiplication of security devices designed to avoid the policy: field warehousing, trust receipts, “factor’s lien” acts and so on. The cushion of free assets has not been preserved. In almost every state it is now possible for the borrower to give a lien on everything he has or will have. There have no doubt been sufficient economic reasons for the change. This Article, in expressly validating the floating charge, merely recognizes an existing state of things. The substantive rules of law set forth in the balance of the Article are designed to achieve the protection of the debtor and the equitable resolution of the conflicting claims of creditors which the old rules no longer give.

4. Subsection (2) states the time at which debtor has rights in collateral in specified cases. A security agreement may be executed and value given before the debtor acquires rights; the security interest will then attach under subsection (1), as to after-acquired property, when he does. Subsection (2) states when that is in several controversial cases. Notice that the vexed question of assignment of future accounts is treated like any other case of after-acquired property: no periodic list of accounts is required by this Act. Where less than all accounts are assigned such a list may of course be necessary to permit identification of the particular accounts assigned.

5. Subsection (3) has been already referred to in connection with after-acquired property. It also serves to validate the so-called “cross-security” clause under which collateral acquired at any time may secure advances whenever made.

6. Subsection (4) (a) follows many state statutes which invalidate long-term security arrangements designed to cover future crops. Under existing statutes varying time limits are stated, the most frequent being one year, the period adopted by this section. The “except” clause permits a security interest in future crops in favor of a real estate lessor, mortgagee, conditional vendor or other encumbrancer during the continuance of

his interest in the realty—this provision, again, is in accord with many existing statutes. Note that the real estate transaction involved must be one of lease or purchase or improvement of the land. Section 9—312(2) should be consulted on the subordination of such an interest to a later interest arising from a current crop production loan.

7. Subsection (4) (b) limits the operation of the after-acquired property clause against consumers. No such interest can be claimed as additional security in consumer goods (defined in Section 9—109), except accessions (see Section 9—314), acquired more than ten days after the giving of value.

8. Under subsection (5) collateral may secure future as well as present advances when the security agreement so provides. At common law and under chattel mortgage statutes there seems to have been a vaguely articulated prejudice against future advance agreements comparable to the prejudice against after-acquired property interests. Although only a very few jurisdictions went to the length of invalidating interest claimed by virtue of future advances, judicial limitations severely restricted the usefulness of such arrangements. A common limitation was that an interest claimed in collateral existing at the time the security transaction was entered into for advances made thereafter was good only to the extent that the original security agreement specified the amount of such later advances and even

the times at which they should be made. In line with the policy of this Article toward after-acquired property interests this subsection validates the future advance interest, provided only that the obligation be covered by the security agreement. This is a special case of the more general provision of subsection (3).

As in the case of interests in after-acquired collateral, a security interest based on future advances may be subordinated to conflicting interests in the same collateral. See Section 9—312(3) and (4).

#### Cross references:

Point 1: Sections 9—301 and 9—302.

Point 2: Sections 9—108 and 9—312.

Point 3: Sections 9—205 and 9—306.

Point 4: Sections 9—110 and 9—203(1)

(b).

Point 6: Section 9—312(2).

Point 7: Sections 9—109 and 9—314.

Point 8: Section 9—312(3) and (4).

#### Definitional cross references:

"Account". Section 9—106.

"Agreement". Section 1—201.

"Collateral". Section 9—105.

"Consumer goods". Section 9—109.

"Contract". Section 1—201.

"Contract right". Section 9—106.

"Debtor". Section 9—105.

"Purchase". Section 1—201.

"Rights". Section 1—201.

"Secured party". Section 9—105.

"Security agreement". Section 9—105.

"Security interest". Section 1—201.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1)* states the rules governing "attachment" of the security interest. The concept of "attachment" and its consequences are, for the most part, new. Under the Code, the security interest has no existence with reference to specific collateral until the three steps necessary for attachment have taken place. This does not mean that the security interest always will have priority dating only from the time of attachment, but there are some situations in which the time attachment is the key to priority. See North Carolina Comment to GS 25-9-312.

*Subsection (2)* specifies the time at which the debtor acquires rights in some specific types of collateral.

*Subsection (2) (a)* does not affect the priority of a lien on crops which is perfected by filing. Priority would date from the time of filing, as it did under prior law. GS 44-52. See GS 25-9-312.

*Subsections (3) and (4)* validate, with exceptions, contractual provisions covering

after-acquired property of the debtor. Former North Carolina statutes expressly provided for bringing after-acquired property under the original security agreement with reference to factor's liens, GS 44-71, and liens on accounts receivable, GS 44-77. The same result was achieved by implication under the statute governing liens on crops for advances. GS 44-52. The validity of the after-acquired property clause in chattel mortgages was covered by common law, and most of the North Carolina cases involved real estate mortgages. However, the same principles should have applied with equal force to mortgages of chattels, and probably did. *Merchants & Farmers Bank v. Clifton*, 186 N.C. 609, 120 S.E. 210 (1923) (by implication). The court had long enforced the after-acquired clause as between the original parties, *White v. Carroll*, 146 N.C. 230, 59 S.E. 678 (1907); *Perry v. White*, 111 N.C. 197, 16 S.E. 172 (1892), and had recognized its validity as to lien creditors and purchasers where the mort-



gage was properly registered before those interests intervened. *Standard Dry Kiln v. Ellington*, 172 N.C. 481, 90 S.E. 564 (1916); *Brown v. Dial*, 117 N.C. 41, 23 S.E. 45 (1895). See also *Hunter v. Scruggs Drug Store, Inc.*, 113 F.2d 971 (4th Cir. 1940). The ultimate usefulness of the after-acquired property clause was, however, qualified by the proposition that the mortgage covered the property as it came into the hands of the debtor, *Standard Dry Kiln Co. v. Ellington*, 172 N.C. 481, 90 S.E. 564 (1916), and the effect of the clause could be completely defeated if all subsequent acquisitions were subject to purchase money security interests. See North Carolina Comment to GS 25-9-312 (4). The Code does not change that rule except as to inventory. See North Carolina Comment to GS 25-9-312 (3).

The one-year limitation for security interests in crops set out in subsection (4) (a) is similar in effect to the former North Carolina rule. GS 44-52.

Subsection (4) (b) limits the validity of after-acquired clauses in security interests covering consumer goods. This limitation probably changes prior law. *Twin City Motor Co. v. Rouzer Motor Co.*, 197 N.C. 371, 148 S.E. 461 (1929) (dictum). However, the rule as to accessions remains the same. *Goodrich Silvertown Stores v. Caesar*, 214 N.C. 85, 197 S.E. 698 (1938) (dictum); *Twin City Motor Co. v. Rouzer Motor Co.*, 197 N.C. 371, 148 S.E. 461 (1929). See also North Carolina Comment to GS 25-9-314.

Subsection (5) validates agreements that the security interest shall cover all future advances. As to the general validity thereof, North Carolina was in accord. In re *Steele*, 122 F. Supp. 948 (E.D.N.C. 1954); *State v. Surles*, 117 N.C. 720, 23 S.E. 324 (1895); *Moore v. Ragland*, 74 N.C. 343 (1876) (real estate mortgage) (dictum).

The final clause of the subsection is designed to displace those decisions which held that a mortgage could not secure future advances unless the mortgagee was obligated to make the advances and the security agreement so specified. See Official Comment 4 to this section. The status of the North Carolina law on this point was not clear and any statement concerning the effect of this section on prior law would be speculation. In *Board of Comm'rs v. Wills & Sons*, 236 Fed. 362 (E.D.N.C. 1916) (dictum), the federal court, quoting from *Jones on Mortgages*, stated: "There is strong reason and authority for the rule that a mortgage to secure future advancements . . . whether the mortgagee be bound to make the advances or not, will prevail over the supervening claims of purchasers or creditors . . ." In a situation where it was not clear whether the mortgagee was obligated to make advances, the court did indicate that the provision for future advances would be valid as to all advances made prior to the time the first mortgagee received notice of the execution of a second mortgage. *Todd v. Outlaw*, 79 N.C. 235 (1878). Whether or not this subsection changes North Carolina law, it clarifies it.

The overall effect of this section, when combined with GS 25-9-205, would be to validate the "floating lien." That is, the parties, in most situations, are free to enter into an agreement which covers all after-acquired property of the debtor and all future advances made by the mortgagee without necessity of restricting the debtor's use of the property or proceeds therefrom. The range of possibilities is not unlike that formerly available to the factor under the North Carolina Factor's Lien Act, GS 44-70 through 44-75, except that the factor's lien device was available only to those persons who advanced money to manufacturers.

**§ 25-9-205. Use or disposition of collateral without accounting permissible.**—A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts, contract rights or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee. (1945, c. 196, s. 7; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. This Article expressly validates the floating charge or lien on a shifting stock.

(See Sections 9-201, 9-204, and Comment to Section 9-204.) This section provides that a security interest is not invalid or fraudulent by reason of liberty

in the debtor to dispose of the collateral without being required to account for proceeds or substitute new collateral. It repeals the rule of *Benedict v. Ratner*, 268 U.S. 353, 45 S.Ct. 566, 69 L.Ed. 991 (1925), and other cases which held such arrangements void as a matter of law because the debtor was given unfettered dominion or control over the collateral. The principal effect of the Benedict rule has been, not to discourage or eliminate security transactions in inventory and accounts receivable—on the contrary such transactions have vastly increased in volume—but rather to force financing arrangements in this field toward a self-liquidating basis. Furthermore several Circuit Court cases drew implications from Justice Brandeis' opinion in *Benedict v. Ratner* which have required lenders operating in this field to observe a number of needless and costly formalities: for example it has been thought necessary for the debtor to make daily remittances to the lender of all collections received, even though the amount remitted is immediately returned to the debtor in order to keep the loan at an agreed level.

2. The Benedict rule has, in the accounts receivable field, been repealed in many of the state accounts receivable statutes which have been enacted since 1943, and, in the inventory field, by some of the factor's lien statutes. (*Benedict v. Ratner* purported to state the law of New York and not a rule of federal bankruptcy law. Since its acceptance is a matter of state law, it can of course be rejected by state statute.)

3. The requirement of "policing" is the substance of the Benedict rule. While this section repeals Benedict in matters of form, the filing requirements (Section 9-302) give other creditors the opportunity to ascertain from public sources whether property of their debtor or prospective debtor is subject to secured claims, and the provisions about proceeds (Section 9-306 (4)) enable creditors to claim

collections which were made by the debtor more than 10 days before insolvency proceedings and commingled or deposited in a bank account before institution of the insolvency proceedings. The repeal of the Benedict rule under this section must be read in the light of these provisions.

4. Other decisions reaching results like that in the Benedict case, but relating to other aspects of dominion (of which *Lee v. State Bank & Trust Co.*, 54 F.2d 518 (2d Cir. 1931), is an example) are likewise rejected.

5. Nothing in Section 9-205 prevents such "policing" or dominion as the secured party and the debtor may agree upon; business and not legal reasons will determine the extent to which strict accountability, segregation of collections, daily reports and the like will be employed.

6. The last sentence is added to make clear that the section does not mean that the holder of an unfiled security interest, whose perfection depends on possession of the collateral by the secured party or by a bailee (such as a field warehouseman), can allow the debtor access to and control over the goods without thereby losing his perfected interest. The common law rules on the degree and extent of possession which are necessary to perfect a pledge interest or to constitute a valid field warehouse are not relaxed by this or any other section of this Article.

#### Cross references:

Point 1: Sections 9-201 and 9-204.  
Point 3: Sections 9-302 and 9-306(4).  
Point 6: Sections 9-304 and 9-305.

#### Definitional cross references:

"Account". Section 9-106.  
"Chattel paper". Section 9-105.  
"Collateral". Section 9-105.  
"Contract right". Section 9-106.  
"Creditor". Section 1-201.  
"Debtor". Section 9-105.  
"Goods". Section 9-105.  
"Proceeds". Section 9-306.  
"Secured party". Section 9-105.  
"Security interest". Section 1-201.

### NORTH CAROLINA COMMENT

This section expressly validates security interests which have any one or all of several factors present which have in the past caused courts to void the security interest as being fraudulent to creditors. The section is intended to change the result in cases like *Benedict v. Ratner*, 268 U.S. 353, 45 Sup. Ct. 566, 69 L. Ed. 991 (1925), wherein the court voided an assignment of accounts receivable which permitted the debtor to retain control of and collect the

accounts without requiring the debtor to account for the proceeds of collection or requiring the debtor to substitute other security to replace the collected accounts.

This section would probably change prior North Carolina law, at least with reference to a mortgage on a stock of merchandise. The court has held that a mortgage on a stock of goods which leaves the debtor in possession with power to dispose of the goods without accounting to the mortgagee

is presumptively fraudulent and void as to existing creditors. *Blaton Grocery Co. v. Taylor*, 162 N.C. 307, 78 S.E. 276 (1913); *Boone v. Hardie*, 87 N.C. 72 (1882); *Cheat-ham v. Hawkins*, 76 N.C. 335 (1877). See also *In re Cleveland*, 146 F. Supp. 765 (E.D.N.C. 1956). Apparently, the determinative factor in those cases was the failure of the mortgagee to require the debtor to account for the proceeds of the sale of the property. It has been held that the rule would not apply to a mortgage on fixtures or other items not in the stock in trade or inventory of the debtor.

If an assignment of accounts receivable was taken for security purposes in North Carolina and perfected under the Assignment of Accounts Receivable Statute, GS 44-77 through 44-85, the statute provided that "Any permission by the assignee to the assignor to exercise dominion and control over a protected assigned account or the proceeds thereof shall not invalidate the assignment as to third persons," GS 44-83, which was generally in accord with this section of the Code. However, compare language in GS 44-84 with GS 44-83.

**§ 25-9-206. Agreement not to assert defenses against assignee; modification of sales warranties where security agreement exists. —**

(1) Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under the article on commercial paper (article 3). A buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.

(2) When a seller retains a purchase money security interest in goods the article on sales (article 2) governs the sale and any disclaimer, limitation or modification of the seller's warranties. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 2, Uniform Conditional Sales Act.

**Changes:** Rewritten and new material added.

**Purposes of changes and new matter:**

1. Clauses are frequently inserted in conditional sale contracts under which the conditional vendee agrees not to assert defenses against an assignee of the contract. These clauses have led to litigation and their present status under the case law is in confusion. In some jurisdictions they have been held void as attempts to create negotiable instruments outside the framework of the Negotiable Instruments Law or on grounds of public policy; in others they have been allowed to operate to cut off at least defenses

The prior law relating to chattel mortgages covering accounts receivable was not so clear. Where an unregistered security agreement gave the debtor control over the accounts with no specific requirements for segregation or use of the proceeds, the security interest was voided. *Sneeden v. Nurnberger's Market*, 192 N.C. 439, 135 S.E. 328 (1926). The court hinted that if the agreement had been registered, the security interest would have been valid. However, a federal district court has applied the rule of *Benedict v. Ratner* in voiding a chattel mortgage of accounts which gave the debtor "unfettered dominion" over the accounts. *In re Steele*, 122 F. Supp. 948 (E.D.N.C. 1954).

Thus, this section changes North Carolina law to some extent, as it would the law of most states. It does not mean, however, that the secured party who does not carefully police his security interest and require periodic accounting of proceeds will have as good a security interest as one who does require those things. See GS 25-9-306 (4).

based on breach of warranty. Under subsection (1) such clauses in a security agreement are validated outside the consumer field, but only as to defenses which could be cut off if a negotiable instrument were used. This limitation is important since if the clauses were allowed to have full effect as typically drafted they would operate to cut off real as well as personal defenses. The execution of a negotiable note in connection with a security agreement is given like effect as the execution of an agreement containing a waiver of defense clause. The same rules are made applicable to leases as to security agreements, whether or not the lease is intended as security.

2. This Article takes no position on the



controversial question whether a buyer of consumer goods may effectively waive defenses by contractual clause or by execution of a negotiable note. In some states such waivers have been invalidated by statute. In other states the course of judicial decision has rendered them ineffective or unreliable—courts have found that the assignee is not protected against the buyer's defense by a clause in the contract or that the holder of a note, by reason of his too close connection with the underlying transaction, does not have the rights of a holder in due course. This Article neither adopts nor rejects the approach taken in such statutes and decisions, except that the validation of waivers in subsection (1) is expressly made "subject to any statute or decision" which may restrict the waiver's effectiveness in the case of a buyer of consumer goods.

3. Subsection (2) makes clear, as did Section 2 of the Uniform Conditional Sales Act, that purchase money security transactions are sales, and warranty rules for sales are applicable. It also prevents a buyer from inadvertently abandoning his warranties by a "no warranties" term in the security agreement when warranties

have already been created under the sales arrangement. Where the sales arrangement and the purchase money security transaction are evidenced by only one writing, that writing may disclaim, limit or modify warranties to the extent permitted by Article 2.

#### Cross references:

Point 1: Section 3—305.

Point 2: Section 9—203(2).

Point 3: Sections 2—102 and 2—316.

#### Definitional cross references:

"Agreement". Section 1—201.

"Consumer goods". Section 9—109.

"Good faith". Section 1—201.

"Goods". Section 9—105.

"Holder". Section 1—201.

"Holder in due course". Sections 2—302 and 9—105.

"Negotiable instrument". Section 3—104.

"Notice". Section 1—201.

"Purchase money security interest". Section 9—107.

"Sale". Sections 2—106 and 9—105.

"Security agreement". Section 9—105.

"Security interest". Section 1—201.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

No North Carolina cases in point have been found. However, most American courts have enforced clauses in conditional sales contracts or chattel mortgages whereby the debtor agreed not to assert defenses against the assignee of the security interest. See, e.g., *Refrigeration Discount Corp. v. Haskew*, 194 Ark. 549, 108 S.W.2d 908 (1937); *Young v. John Deere Plow Co.*, 102 Ga. App. 132, 115 S.E.2d 770 (1960); *Commercial Credit Corp. v. Biagi*, 11 Ill. App. 2d 80, 136 N.E.2d 580 (1956). However, it is generally considered to be against public policy to permit such a waiver to

defeat the defense of fraud of the seller. See, e.g., *Equipment Acceptance Corp. v. Arwood Can Mfg. Co.*, 117 F.2d 442 (6th Cir. 1941); *Pacific Acceptance Corp. v. Whalen*, 43 Idaho 15, 248 Pac. 444 (1926). The approach of this section of the Code is similar; that is, the clauses waiving defenses will be enforced except as to defenses which are available against a holder in due course of a negotiable instrument.

Apparently there is no North Carolina statute relating to consumer goods which would restrict the general operation of this section.

**§ 25-9-207. Rights and duties when collateral is in secured party's possession.**—(1) A secured party must use reasonable care in the custody and preservation of collateral in his possession. In the case of an instrument or chattel paper reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(2) Unless otherwise agreed, when collateral is in the secured party's possession

(a) reasonable expenses (including the cost of any insurance and payment of taxes or other charges) incurred in the custody, preservation, use or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(b) the risk of accidental loss or damage is on the debtor to the extent of any deficiency in any effective insurance coverage;

(c) the secured party may hold as additional security any increase or profits (except money) received from the collateral, but money so received, unless remitted to the debtor, shall be applied in reduction of the secured obligation;

(d) the secured party must keep the collateral identifiable but fungible collateral may be commingled;

(e) the secured party may repledge the collateral upon terms which do not impair the debtor's right to redeem it.

(3) A secured party is liable for any loss caused by his failure to meet any obligation imposed by the preceding subsections but does not lose his security interest.

(4) A secured party may use or operate the collateral for the purpose of preserving the collateral or its value or pursuant to the order of a court of appropriate jurisdiction or, except in the case of consumer goods, in the manner and to the extent provided in the security agreement. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. Subsection (1) states the duty to preserve collateral imposed on a pledgee at common law. See Restatement of Security, §§ 17, 18. In many cases a secured party having collateral in his possession may satisfy this duty by notifying the debtor of any act which must be taken and allowing the debtor to perform such act himself. If the secured party himself takes action, his reasonable expenses may be added to the secured obligation.

Under Section 1—102(3) the duty to exercise reasonable care may not be disclaimed by agreement, although under that section the parties remain free to determine by agreement, in any manner not manifestly unreasonable, what shall constitute reasonable care in a particular case.

2. Subsection (2) states rules, which follow common law precedents, and which apply, unless there is agreement otherwise, in typical situations during the period while the secured party is in possession of the collateral.

3. The right of a secured party holding instruments or documents to have them indorsed or transferred to him or his order is dealt with in the relevant sections of Articles 3 (Commercial Paper), 7 (Warehouse Receipts, Bills of Lading and Other Documents) and 8 (Investment

Securities). (Sections 3—201, 7—506, 8—307.)

4. This section applies when the secured party has possession of the collateral before default, as a pledgee, and also when he has taken possession of the collateral after default. See Section 9—501(1) and (2). Subsection (4) permits operation of the collateral in the circumstances stated, and subsection (2) (a) authorizes payment of or provision for expenses of such operation. Agreements providing for such operation are common in trust indentures securing corporate bonds and are particularly important when the collateral is a going business. Such an agreement cannot of course disclaim the duty of care established by subsection (1), nor can it waive or modify the rights of the debtor contrary to Section 9—501(3).

**Cross references:**

Point 1: Section 1—102(3).

Point 3: Sections 3—201, 7—506 and 8—307.

Point 4: Section 9—501(2) and Part 5.

**Definitional cross references:**

"Chattel paper". Section 9—105.

"Collateral". Section 9—105.

"Debtor". Section 9—105.

"Instrument". Section 9—105.

"Money". Section 1—201.

"Party". Section 1—201.

"Secured party". Section 9—105.

"Security interest". Section 1—201.

#### NORTH CAROLINA COMMENT

Subsection (1) states the common-law rule that the pledgee has a duty to use reasonable care in preservation of collateral in his possession.

The second sentence of subsection (1) is probably in accord with prior North Carolina law. In *Hickson Lumber Co. v. Pollock*, 139 N.C. 174, 51 S.E. 855 (1905), the court stated: "When a creditor takes a note of a third person as collateral security for his debt, he is bound to use due diligence in the collection of the collateral." In addition,

the creditor was entitled to receive reasonable expenses incurred in the protection and collection of the collateral. *Hickson Lumber Co. v. Pollock*, 139 N.C. 174, 51 S.E. 855 (1905). This is in accord with subsection (2) (a).

No North Carolina cases have been found covering the other points made in this section, but it is reasonable to assume that North Carolina would have been substantially in accord with this section.

**§ 25-9-208. Request for statement of account or list of collateral.—**

(1) A debtor may sign a statement indicating what he believes to be the aggregate amount of unpaid indebtedness as of a specified date and may send it to the secured party with a request that the statement be approved or corrected and returned to the debtor. When the security agreement or any other record kept by the secured party identifies the collateral a debtor may similarly request the secured party to approve or correct a list of the collateral.

(2) The secured party must comply with such a request within two weeks after receipt by sending a written correction or approval. If the secured party claims a security interest in all of a particular type of collateral owned by the debtor he may indicate that fact in his reply and need not approve or correct an itemized list of such collateral. If the secured party without reasonable excuse fails to comply he is liable for any loss caused to the debtor thereby; and if the debtor has properly included in his request a good faith statement of the obligation or a list of the collateral or both the secured party may claim a security interest only as shown in the statement against persons misled by his failure to comply. If he no longer has an interest in the obligation or collateral at the time the request is received he must disclose the name and address of any successor in interest known to him and he is liable for any loss caused to the debtor as a result of failure to disclose. A successor in interest is not subject to this section until a request is received by him.

(3) A debtor is entitled to such a statement once every six months without charge. The secured party may require payment of a charge not exceeding ten dollars (\$10.00) for each additional statement furnished. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. To provide a procedure whereby a debtor may obtain from the secured party a statement of the amount due on the obligation and in some cases a statement of the collateral.

2. The financing statement required to be filed under this Article (see Section 9—402) may disclose only that a secured party may have a security interest in specified types of collateral owned by the debtor. Unless a copy of the security agreement itself is filed as the financing statement third parties are told neither the amount of the obligation secured nor which particular assets are covered. Since subsequent creditors and purchasers may legitimately need more detailed information, it is necessary to provide a procedure under which the secured party will be required to make disclosure. On the other hand, the secured party should not be under a duty to disclose details of business operations to any casual inquirer or competitor who asks for them. This section gives the right to demand disclosure only to the debtor, who will typically request

a statement in connection with negotiations with subsequent creditors and purchasers, or for the purpose of establishing his credit standing and proving which of his assets are free of the security interest. The secured party is further protected against onerous requests by the provisions that he need furnish a statement of collateral only when his own records identify the collateral and that if he claims all of a particular type of collateral owned by the debtor he is not required to approve an itemized list.

**Cross reference:**

Point 2: Section 9—402.

**Definitional cross references:**

"Collateral". Section 9—105.

"Debtor". Section 9—105.

"Good faith". Section 1—201.

"Know". Section 1—201.

"Person". Section 1—201.

"Receive". Section 1—201.

"Secured party". Section 9—105.

"Security agreement". Section 9—105.

"Security interest". Section 1—201.

"Send". Section 1—201.

"Written". Section 1—201.

**NORTH CAROLINA COMMENT**

As to the similar rights of a person who has borrowed money from a finance company covered by the North Carolina Con-

sumer Finance Act, see GS 53-181 and 53-182.



## PART 3.

## RIGHTS OF THIRD PARTIES; PERFECTED AND UNPERFECTED SECURITY INTERESTS; RULES OF PRIORITY.

§ 25-9-301. **Persons who take priority over unperfected security interests; "lien creditor."**—(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

(a) persons entitled to priority under § 25-9-312;

(b) a person who becomes a lien creditor without knowledge of the security interest and before it is perfected;

(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) in the case of accounts, contract rights, and general intangibles, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within ten days after the collateral comes into possession of the debtor, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment. Unless all the creditors represented had knowledge of the security interest such a representative of creditors is a lien creditor without knowledge even though he personally has knowledge of the security interest. (1945, c. 182, s. 4; c. 196, s. 4; 1955, c. 386, s. 2; 1961, c. 574; 1965, c. 700, s. 1.)

**Registration Was Not Necessary Inter Partes.**—A crop lien to secure agricultural advances was held valid inter partes, although not registered within the time required by statute. *Gay v. Nash*, 78 N.C. 100 (1878). See *Reese & Co. v. Cole*, 93 N.C. 87 (1885).

**But Registration of Crop Liens Was**

**Necessary as to Third Parties.**—See *Gay v. Nash*, 78 N.C. 100 (1878).

It was held that a mortgage on a crop, not expressed to be for advances, and not registered within the time formerly required, had no rights as an agricultural lien. *Cooper v. Kimball*, 123 N.C. 120, 31 S.E. 346 (1898).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 8(2) and 9(2) (b), Uniform Trust Receipts Act; Section 5, Uniform Conditional Sales Act.

**Changes:** Changed in substance.

**Purposes of changes:**

1. This section lists the classes of persons who take priority over an unperfected security interest. As in Section 60 of the Federal Bankruptcy Act, the term "perfected" is used to describe a security interest in personal property which cannot be defeated in insolvency proceedings or in general by creditors. A security interest is "perfected" when the secured party has taken whatever steps are necessary to give him such an interest. These steps are explained in the five following sections (9—302 through 9—306).

2. Section 9—312 states general rules for the determination of priorities among conflicting security interests and in addition contains a list of other sections which state special rules of priority in a variety of situations. The interests given priority under Section 9—312 and the other sections therein listed take such priority in general even over a perfected security interest. *A fortiori* they take priority over an unperfected security interest, and subsection (1) (a) of this section so states.

3. Subsection (1) (b) follows the Uniform Trust Receipts Act and Uniform Conditional Sales Act and the rule under some chattel mortgage legislation. It provides that an unperfected security interest is subordinate to the rights of lien creditors who acquire their liens without

knowledge of the prior security interest and before it is perfected. The section rejects the rule, applied in many jurisdictions to chattel mortgages and in a few to conditional sales, that an unperfected security interest is subordinated to all creditors. The section subordinates the unperfected security interest but does not subordinate the debt.

4. Subsections (1) (c) and (1) (d) deal with purchasers (other than secured parties) of collateral who would take subject to a perfected security interest but who are by these subsections given priority over an unperfected security interest. In the cases of goods and of intangibles of the type whose transfer is effected by physical delivery of the representative piece of paper (instruments, documents and chattel paper) the purchaser who takes priority must both give value and receive delivery of the collateral without knowledge of the existing security interest and before perfection (subsection (1) (c)). Thus even if the purchaser gave value without knowledge and before perfection, he would take subject to the security interest if perfection occurred before physical delivery of the collateral to him. The subsection (1) (c) rule is obviously not appropriate where the collateral consists of intangibles and there is no representative piece of paper whose physical delivery is the only or the customary method of transfer. Therefore with respect to such intangibles (accounts, contract rights and general intangibles), subsection (1) (d) gives priority to any transferee who has given value without knowledge and before perfection of the security interest.

The term "buyer in ordinary course of business" referred to in subsection (1) (c) is defined in Section 1-201(9).

Other secured parties are excluded from subsections (1) (c) and (1) (d) because their priorities are covered in Section 9-312 (see point 2 of this Comment).

5. Except to the extent provided in subsection (2) this Article does not permit a secured party to file or take possession

after another interest has received priority under subsection (1) and thereby protect himself against the intervening interest.

A few chattel mortgage statutes did have grace periods, i. e., a filing within x days after the mortgage was given related back to the day the mortgage was given. The Uniform Conditional Sales Act had a ten-day period which cut off all intervening interests. The Uniform Trust Receipts Act had a thirty-day period but did not cut off the interest of a purchaser who took delivery before the filing.

Subsection (2) gives a grace period for perfection by filing as to purchase money security interests only (that term is defined in Section 9-107). The grace period runs for ten days after the collateral comes into possession of the debtor but operates to cut off only the interests of intervening lien creditors or bulk purchasers.

6. Subsection (3) defines "lien creditor", following in substance the provisions of the Uniform Trust Receipts Act.

#### **Cross references:**

Section 9-312.

Point 1: Sections 9-302 through 9-306.

#### **Definitional cross references:**

"Account." Section 9-106.

"Buyer in ordinary course of business". Section 1-201.

"Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Contract right". Section 9-106.

"Creditor". Section 1-201.

"Delivery". Section 1-201.

"Document". Section 9-105.

"General intangibles". Section 9-106.

"Goods". Section 9-105.

"Instrument". Section 9-105.

"Knowledge". Section 1-201.

"Person". Section 1-201.

"Purchase money security interest". Section 9-107.

"Representative". Section 1-201.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

### **NORTH CAROLINA COMMENT**

This section results in a significant revision of the North Carolina concept of priorities of lien creditors and purchasers for value. The prior equivalents of an "unperfected security interest" were chattel mortgages or conditional sales which had not been registered, or purported pledges where the property was not in the possession of the pledgee. With the exception of the Uniform Trust Receipts Act, GS 45-53, the North Carolina registration statutes were

deemed to express a strong public policy in favor of registration. Notice or actual knowledge of the security interest was not a substitute for registration. Thus, lien creditors or purchasers for value prevailed over the unregistered security interest even though they had actual knowledge of its existence at the time they acquired their interest in the property. See *Smith v. Turnage-Winslow Co.*, 212 N.C. 310, 193 S.E. 685 (1937) (dictum); North State Piano

Co. v. Spruill & Bros., 150 N.C. 168, 63 S.E. 723 (1909). Adoption of the Code changes this by establishing "lack of knowledge" as an element of the priority status of lien creditors and purchasers. GS 25-9-301 (1) (b) and (c).

Another change is the introduction of a ten-day "grace period" within which to file a purchase money security interest. If the financing statement is filed within ten days after the debtor receives possession of the collateral, the filing "relates back" to the day of delivery of possession and the security interest prevails over intervening lien creditors or transferees in bulk. See also North Carolina Comment to GS 25-9-312. Prior North Carolina law did not generally recognize the relation back concept, except as to trust receipts, GS 45-53, wherein the grace period was thirty days, and as to security interests in automobiles, GS 20-58.

However, conceding the two broad conceptual changes, the results under the Code will be essentially the same as under prior law.

*Subsection (1) (a)* gives lien creditors priority over unperfected security interests. As heretofore indicated, the North Carolina rule was the same as to chattel mortgages and other security interests which were not registered. See *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960) (dictum); *M. & J. Fin. Co. v. Hodges*, 230 N.C. 580, 55 S.E.2d 201 (1949).

*Subsection (1) (b)* extends the same priority to purchasers for value in the situations specified. This is generally in accord with prior law. However, it should be noted with reference to this section that under North Carolina law a subsequent mortgagee or other secured party was treated as a "purchaser for value." *North State Piano Co. v. Spruill & Bros.*, 150 N.C. 168,

63 S.E. 723 (1909). Under the Code this will not be true. The relative priorities between secured parties are dealt with in GS 25-9-312. Also, the "buyer in the ordinary course of business" receives a special priority under the Code which was not generally available in North Carolina. See North Carolina Comment to GS 25-9-307.

*Subsection (2)* has been dealt with above.

*Subsection (3)* sets forth the definition of a "lien creditor." This definition is in accord with prior North Carolina law. A "creditor" whose rights were superior to an unrecorded security agreement was a creditor who had fastened his lien upon the personal property of the debtor by levy under execution of judgment, *M. & J. Fin. Co. v. Hodges*, 230 N.C. 580, 55 S.E.2d 201 (1949); *Penland v. Leatherwood*, 101 N.C. 509, 8 S.E. 234 (1888), or by attachment, *Salassa v. Western Carolina Title & Mortgage Co.*, 196 N.C. 501, 146 S.E. 83 (1929). Also, a trustee under deed of assignment for benefit of creditors, *Brem v. Lockhart*, 93 N.C. 191 (1885), a trustee in bankruptcy, *M. & J. Fin. Co. v. Hodges*, 230 N.C. 580, 55 S.E.2d 201 (1949) (dictum), and a receiver in an equitable insolvency proceeding, *General Motors Acceptance Corp. v. Mayberry*, 195 N.C. 508, 142 S.E. 767 (1928), prevailed over security interests which were not registered. See also GS 45-53. Earlier drafts of this section of the Code indicated that a person would become a lien creditor at the time of the issuance of the process which results in attachment or levy. However, no such intention is expressed in the 1962 draft and, hence, the North Carolina rule that one becomes a "lien creditor" at the time of the actual levy is not affected by this section.

**§ 25-9-302. When filing is required to perfect security interest; security interests to which filing provisions of this article do not apply.**—(1) A financing statement must be filed to perfect all security interests except the following:

(a) a security interest in collateral in possession of the secured party under § 25-9-305;

(b) a security interest temporarily perfected in instruments or documents without delivery under § 25-9-304 or in proceeds for a ten-day period under § 25-9-306;

(c) a purchase money security interest in farm equipment having a purchase price not in excess of twenty-five hundred dollars (\$2500.00); but filing is required for a fixture under § 25-9-313 and compliance with subsections (3) and (4) of this section is required for a motor vehicle required to be licensed;

(d) a purchase money security interest in consumer goods; but filing is required for a fixture under § 25-9-313 and compliance with subsections (3) and (4) of this section is required for a motor vehicle required to be licensed;

(e) an assignment of accounts or contract rights which does not alone or in



conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts or contract rights of the assignor;

(f) a security interest of a collecting bank (§ 25-4-208) or arising under the article on sales (see § 25-9-113) or covered in subsection (3) of this section.

(2) If a secured party assigns a perfected security interest, no filing under this article is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(3) The filing provisions of this article do not apply to a security interest in property subject to a statute

(a) of the United States which provides for a national registration or filing of all security interests in such property; or

(b) of this State which provides for central filing of, or which requires indication on a certificate of title of, such security interests in such property.

(4) A security interest in property covered by a statute described in subsection (3) can be perfected only by registration or filing under that statute or by indication of the security interest on a certificate of title or a duplicate thereof by a public official.

(5) The filing provisions of this article do not apply to a security interest in property of any description or any interest therein created by a deed of trust or mortgage made by a public utility as defined in G.S. 62-3(23), but the deed of trust or mortgage shall be registered in the county or counties in which such deed of trust or mortgage is required by G.S. 47-20 to be registered. (1866-7, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C. S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 3; c. 196, s. 2; 1955, c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1.)

**Editor's Note.** — Subsection (3) (b) is "Alternative A," discussed in Official Comment 8 and the North Carolina Comment to this section.

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 5, Uniform Conditional Sales Act; Section 8, Uniform Trust Receipts Act.

**Purpose of changes:** Modified to conform to the scheme of this Article.

1. Subsection (1) states the general rule that to perfect a security interest under this Article a financing statement must be filed. Subsections (1) (a) through (1) (f) exempt from the filing requirement the transactions described. Subsection (3) further sets out certain transactions to which the filing provisions of this Article do not apply: these are cases where alternative systems for giving public notice of a security interest are available. Section 9-303 states the time when a security interest is perfected by filing or otherwise. Part 4 of the Article deals with the mechanics of filing: place of filing form of financing statement and so on.

2. As at common law, there is no requirement of filing when the secured party has possession of the collateral in a pledge transaction (subsection (1) (a)). Section 9-305 should be consulted on what collateral may be pledged and on the requirements of possession.

3. Under this Article, as under the Uniform Trust Receipts Act, filing is not effective to perfect a security interest in instruments. See Section 9-304(1).

4. Where goods subject to a security interest are left in the debtor's possession, the only exceptions from the general filing requirement are those stated in subsections (1) (c) and (1) (d): purchase money security interests in consumer goods and in certain farm equipment, other than fixtures and motor vehicles. In many jurisdictions under prior law security interests in consumer goods under conditional sale or bailment lease have not been subject to filing requirements. Subsections (1) (c) and (1) (d) follow the policy of those jurisdictions. The subsections change prior law in jurisdictions where all conditional sales and bailment leases have been subject to filing requirements.

Although the security interests described in subsections (1) (c) and (1) (d) are perfected without filing, Section 9-307(2) provides that unless a financing statement is filed certain buyers may take free of the security interest even though perfected. See that section and the Comment thereto.

On filing for security interests in motor vehicles, see subsection (3) (b) of this section.

5. A financing statement must be filed to perfect a security interest in accounts or contract rights, except for the transactions described in subsection (1) (e). It should be noted that this Article

applies to sales of accounts, contract rights or chattel paper as well as to transfers of such intangibles for security (Section 9—102(1) (b)); the filing requirement of this section applies both to sales and to transfers for security. In this respect this Article follows many of the state statutes regulating assignments of accounts receivable.

Over forty jurisdictions have enacted accounts receivable statutes. About half of these statutes require filing to protect or perfect assignments; of the remainder, one is a so-called “book-marking” statute and the others validate assignments without filing. This Article adopts the filing requirement, on the theory that there is no valid reason why public notice is less appropriate for assignments of accounts and contract rights than for any other type of nonpossessory interest. Section 9—305, furthermore, excludes accounts and contract rights from the types of collateral which may be the subject of a possessory security interest: filing is thus the only means of perfection contemplated by this Article.

The purpose of the subsection (1) (e) exemptions is to save from *ex post facto* invalidation casual or isolated assignments: some accounts receivable statutes have been so broadly drafted that all assignments, whatever their character or purpose, fall within their filing provisions. Under such statutes many assignments which no one would think of filing may be subject to invalidation. The subsection (1) (e) exemptions go to that type of assignment. Any person who regularly takes assignments of any debtor's accounts should file. In this connection Section 9—104(f) which excludes certain transfers of accounts and contract rights from the Article should be consulted.

6. With respect to the subsection (1) (f) exemptions, see the sections referred to and Comments thereto.

7. The following example will explain the operation of subsection (2): Buyer buys goods from seller who retains a security interest in them which he perfects. Seller assigns the perfected security interest to X. The security interest, in X's hands and without further steps on his part, continues perfected against Buyer's transferees and creditors. If, however, the assignment from Seller to X was itself intended for security (or was a sale of accounts, contract rights or chattel paper), X must take whatever steps may be required for perfection in order to be protected against Seller's transferees and creditors.

8. Subsection (3) exempts from the filing provisions of this Article transactions as to which an adequate system of filing, state or federal, has been set up outside this Article and subsection (4) makes clear that when such a system exists perfection of a relevant security interest can be had only through compliance with that system (i. e., filing under this Article is not a permissible alternative).

Examples of the type of federal statute referred to in subsection (3) (a) are the provisions of 17 U.S.C. §§ 28, 30 (copyrights), 49 U.S.C. § 523 (aircraft), 49 U.S.C. § 20 (c) (railroads). The Assignment of Claims Act of 1940, as amended, provides for notice to contracting and disbursing officers and to sureties on bonds but does not establish a national filing system and therefore is not within the scope of subsection (3) (a). An assignee of a claim against the United States, who must of course comply with the Assignment of Claims Act, must also file under this Article in order to perfect his security interest against creditors and transferees of his assignor.

Some states have enacted central filing statutes with respect to security transactions in kinds of property which are of special importance in the local economy. Subsection (3) (b) adopts such statutes as the appropriate filing system for such property.

In addition to such central filing statutes many states have enacted certificate of title laws covering motor vehicles and the like. If a certificate of title law requires the indication of all security interests on the certificate, subsection (3) (b) exempts transactions covered by the law from the filing requirements of this Article. (Alternative A.) If a certificate of title law requires a certificate to be issued and a notation of all security interests affecting the property can be indicated on the certificate by a public official (even though the law does not require the indication to be made), subsection (3) (b) exempts transactions covered by the law from the filing requirements of this Article (Alternative B).

9. Perfection of a security interest under a state or federal statute of the type referred to in subsection (3) has all the consequences of perfection under the provisions of this Article.

#### Cross references:

- Point 1: Section 9—303 and Part 4.
- Point 2: Section 9—305.
- Point 3: Section 9—304(1).
- Point 4: Section 9—307(2).

Point 5: Sections 9—102(1) (b), 9—104(f) and 9—305.

Point 6: Sections 4—208 and 9—113.

**Definitional cross references:**

"Account". Section 9—106.

"Collateral". Section 9—105.

"Consumer goods". Section 9—109.

"Contract right". Section 9—106.

"Creditor". Section 1—201.

"Debtor". Section 9—105.

"Delivery". Section 1—201.

"Document". Section 9—105.

"Equipment". Section 9—109.

"Instrument". Section 9—105.

"Inventory". Section 9—109.

"Proceeds". Section 9—306.

"Purchase". Section 1—201.

"Purchase money security interest". Section 9—107.

"Sale". Sections 2—106 and 9—105.

"Secured party". Section 9—105.

"Security interest". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1) (a)* is probably in accord with prior North Carolina law. Although there had been some confusion in the past, it appeared that in all cases a secured party in possession of the collateral was protected from lien creditors or purchasers even though the security agreement had not been registered. *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960). Accord: GS 44-52 (b), 44-75.

Under prior law, if the debtor had possession of the collateral, conditional sales contracts, GS 47-20, chattel mortgages, GS 47-20, liens on crops for advances, GS 44-52, factor's liens, GS 44-72, and liens on accounts receivable had to be registered in order to protect the secured party from intervention of the rights of lien creditors, and where applicable, purchasers for value. Trust receipt transactions were protected from lien creditors for thirty days without filing; and, if the financing statements were filed within the thirty-day period following the delivery of the collateral to the debtor, the perfection related back to the day of delivery. GS 45-53.

*Subsection (1) (b)* is generally in accord with the Uniform Trust Receipts Act, GS 45-53 (b). See also, GS 25-9-304 and 45-54.

*Subsections (1) (c) and (1) (d)* provide that purchase money security interests in farm equipment with a purchase price of less than \$2,500 and in consumer goods may be perfected without filing. However, the perfection without filing does not result in complete protection. See North Carolina Comment to GS 25-9-307 (2). Prior law did not recognize such exemptions from filing; all nonpossessory security interests

had to be registered for protection from lien creditors and purchasers for value.

*Subsection (1) (e)*: The North Carolina Assignment of Accounts Receivable Statute, GS 44-77 through 44-85, was worded so broadly that in all probability every assignment of accounts as defined therein, was included in the filing provisions. Subsection (1) (e) exempts from the filing requirements of the Code assignments which do not constitute a "significant part of the outstanding accounts" of the debtor, and to this extent it probably changes North Carolina law.

*Subsection (2)* is in accord with the North Carolina decisions. See *Cutter Realty Co. v. Dunn Moneyhun Co.*, 204 N.C. 651, 169 S.E. 274 (1933) (by implication); *Hodges v. Wilkinson*, 111 N.C. 56, 15 S.E. 941 (1892).

*Subsection (3)*: North Carolina has adopted Alternative A of subsection (3). The effect of that alternative is to preserve the operation of the North Carolina certificate of title law relating to motor vehicles and the perfection of security interests therein. GS 20-58 through 20-58.10. This North Carolina statute does not apply to security interests created by a dealer or manufacturer who holds the vehicle for resale, GS 20-58.9; therefore, those security interests are governed by the Code filing provisions.

Furthermore, the substantive provisions of the Code relating to the creation of the security interest in all motor vehicles and the rights and duties of the parties with reference thereto are governed by the Code. Only the perfection of that security interest is governed by other law.

**§ 25-9-303. When security interest is perfected; continuity of perfection.**—(1) A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in §§ 25-9-302, 25-9-304, 25-9-305, and 25-9-306. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

(2) If a security interest is originally perfected in any way permitted under this article and is subsequently perfected in some other way under this article, without an intermediate period when it was unperfected, the security interest shall be



deemed to be perfected continuously for the purposes of this article. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. The term "attach" is used in this Article to describe the point at which property becomes subject to a security interest. The requisites for attachment are stated in Section 9-204. When it attaches a security interest may be either perfected or unperfected: "Perfected" means that the secured party has taken all the steps required by this Article as specified in the several sections listed in subsection (1). A perfected security interest may still be or become subordinate to other interests (see Section 9-312) but in general after perfection the secured party is protected against creditors and transferees of the debtor and in particular against any representative of creditors in insolvency proceedings instituted by or against the debtor. Subsection (1) states the truism that the time of perfection is when the security interest has attached and any necessary steps for perfection (such as taking possession or filing) have been taken. If the steps for perfection have been taken in advance (as when the secured party files a financing statement before giving value or before the debtor acquires rights in the collateral), then the interest is perfected automatically when it attaches.

2. The following example will illustrate the operation of subsection (2): A bank which has issued a letter of credit honors drafts drawn under the credit and receives possession of the negotiable bill of lading covering the goods shipped. Under Sections 9-304(2) and 9-305 the bank now has a perfected security interest in the document and the goods. The bank releases the bill of lading to the debtor for the purpose of procuring the goods from the carrier and selling them. Under Section 9-304(5) the bank continues to have a perfected security interest in the docu-

ment and goods for 21 days. The bank files before the expiration of the 21 day period. Its security interest now continues perfected for as long as the filing is good. The goods are sold by the debtor. The bank continues to have a security interest in the proceeds of sale to the extent stated in Section 9-306(3).

If the successive stages of the bank's security interest succeed each other without an intervening gap, the security interest is "continuously perfected" and the date of perfection is when the interest first became perfected (i. e., in the example given, when the bank received possession of the bill of lading against honor of the drafts). If, however, there is a gap between stages—for example, if the bank does not file until after the expiration of the 21 day period specified in Section 9-304(5), the collateral still being in the debtor's possession—then, the chain being broken, the perfection is no longer continuous. The date of perfection would now be the date of filing (after expiration of 21 day period); the bank's interest might now become subject to attack under Section 60 of the Federal Bankruptcy Act and would be subject to any interests arising during the gap period which under Section 9-301 take priority over an unperfected security interest.

The rule of subsection (2) would also apply to the case of collateral brought into this state subject to a security interest which became perfected in another state or jurisdiction. See Section 9-103(3).

#### Cross references:

Sections 9-302, 9-304, 9-305 and 9-306.

Point 1: Sections 9-204 and 9-312.

Point 2: Sections 9-103(3) and 9-301.

#### Definitional cross reference:

"Security interest". Section 1-201.

#### NORTH CAROLINA COMMENT

The first sentence of subsection (1) states the obvious. The third sentence acknowledges that a security agreement may be filed before any of the steps toward perfection have taken place, more particularly, before the secured party has given value or the debtor has acquired any rights in the property. It is apparently well settled in North Carolina that the original filing of a security agreement which covers after-acquired property is sufficient without the

necessity of additional filing each time the debtor acquires the new property. See North Carolina Comment to GS 25-9-204. This is consistent with the Code. The same reasoning should support the view that the filing of a security agreement covering a specific item, before that item is owned by the mortgagor, would be valid as to lien creditors and purchasers. No cases involving chattels have been found. But see *Jackson v. Mills*, 186 N.C. 52, 118 S.E.

835 (1923) (involving estoppel as to real property); *Builders Sash & Door Co. v. Joyner*, 182 N.C. 518, 109 S.E. 259 (1921) (real property).

Subsection (2) provides for continuous perfection of the security interest where the changing character of the collateral for perfection purposes may require differing

methods of perfection. If there is no lapse in perfection, all subsequent perfections relate back to the time of the original perfection. This is probably in accord with prior North Carolina law. Cf. *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960).

**§ 25-9-304. Perfection of security interest in instruments, documents, and goods covered by documents; perfection by permissive filing; temporary perfection without filing or transfer of possession.**—(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in instruments (other than instruments which constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5).

(2) During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

(3) A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.

(4) A security interest in instruments or negotiable documents is perfected without filing or the taking of possession for a period of twenty-one days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(5) A security interest remains perfected for a period of twenty-one days without filing where a secured party having a perfected security interest in an instrument, a negotiable document or goods in possession of a bailee other than one who has issued a negotiable document therefor

(a) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange; or

(b) delivers the instrument to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal or registration of transfer.

(6) After the twenty-one day period in subsections (4) and (5) perfection depends upon compliance with applicable provisions of this article. (1961, c. 574; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 3 and 8(1), Uniform Trust Receipts Act.

**Changes:** Revised to conform to the scheme of this Article.

#### Purposes:

1. For most types of property, filing and taking possession are alternative methods of perfection. For some types of intangibles (i. e., accounts, contract rights and general intangibles) filing is the only available method (see Section 9—305 and Point 1 of Comment thereto). With respect to instruments subsection (1) provides that, except for the cases of "temporary perfection" covered in subsections (4) and (5), taking possession is the only available method; this provision follows the Uniform

Trust Receipts Act. The rule is based on the thought that where the collateral consists of instruments, it is universal practice for the secured party to take possession of them in pledge; any surrender of possession to the debtor is for a short time; therefore it would be unwise to provide the alternative of perfection for a long period by filing which, since it in no way corresponds with commercial practice, would serve no useful purpose. Subsection (1) further provides that filing is available as a method of perfection for security interests in chattel paper and negotiable documents, which also come within Section 9—305 on perfection by possession. Chattel paper is sometimes delivered to the assignee, sometimes left

in the hands of the assignor for collection; subsection (1) allows the assignee to perfect his interest by filing in the latter case. Negotiable documents may be, and usually are, delivered to the secured party; subsection (1) follows the Uniform Trust Receipts Act in allowing filing as an alternative method of perfection. Perfection of an interest in a non-negotiable document is covered in subsection (3).

2. Subsection (2), following prior law and consistently with the provisions of Article 7, takes the position that, so long as a negotiable document covering goods is outstanding, title to the goods is, so to say, locked up in the document and the proper way of dealing with such goods is through the document. Perfection therefore is to be made with respect to the document and, when made, automatically carries over to the goods. Any interest perfected directly in the goods while the document is outstanding (for example, a chattel mortgage on goods in a warehouse) is subordinated to an outstanding negotiable document.

3. Subsection (3) takes a different approach to the problem of goods covered by a non-negotiable document or otherwise in the possession of a bailee who has not issued a negotiable document. Here title to the goods is not looked on as being locked up in the document and the secured party may perfect his interest directly in the goods by filing as to them. The subsection states two other methods of perfection: issuance of the document in the secured party's name (as consignee of a straight bill of lading or the person to whom delivery would be made under a non-negotiable warehouse receipt) and receipt of notification of the secured party's interest by the bailee which, under Section 9-305, is looked on as equivalent to taking possession by the secured party.

4. Subsections (4) and (5) follow the Uniform Trust Receipts Act in giving perfected status to security interests in instruments and documents for a short period although there has been no filing and the collateral is in the debtor's possession. The period of 21 days is chosen to conform to the provisions of Section 60

of the Federal Bankruptcy Act. There are a variety of legitimate reasons—some of them are described in subsections (5) (a) and (5) (b)—why such collateral has to be temporarily released to a debtor and no useful purpose would be served by cluttering the files with records of such exceedingly short term transactions. Under subsection (4) the 21 day perfection runs from the date of attachment; there is no limitation on the purpose for which the debtor is in possession but the secured party must have given new value under a written security agreement. Under subsection (5) the 21 day perfection runs from the date a secured party who already has a perfected security interest turns over the collateral to the debtor (an example is a bank which has acquired a bill of lading by honoring drafts drawn under a letter of credit and subsequently turns over the bill of lading to its customer); there is no new value requirement but the turn-over must be for one or more of the purposes stated in subsections (5) (a) and (5) (b). Note that while subsection (4) is restricted to instruments and *negotiable* documents, subsection (5) extends to goods covered by non-negotiable documents as well. Thus the letter of credit bank referred to in the example could make a subsection (5) turn-over without regard to the form of the bill of lading, provided that, in the case of a non-negotiable document, it had previously perfected its interest under one of the methods stated in subsection (3).

#### Cross references:

Article 7 and Sections 9-303 and 9-305.

#### Definitional cross references:

"Chattel paper". Section 9-105.

"Debtor". Section 9-105.

"Document". Section 9-105.

"Goods". Section 9-105.

"Instrument". Section 9-105.

"Receives" notification. Section 1-201.

"Sale". Sections 2-106 and 9-105.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

"Written". Section 1-201.

### NORTH CAROLINA COMMENT

*Subsection (1)*, in permitting perfection of a security interest in negotiable documents by filing, is substantially in accord with the Uniform Trust Receipts Act, GS 45-47. However, see GS 25-9-309 for the extent of protection afforded by filing. A security interest in instruments can be perfected only by possession.

*Subsection (5)* permits return of possession of certain collateral to the debtor for certain purposes without loss of perfection. This is analogous to the right of a pledgee to return goods under prior law, except that prior law set no definite time limit. See *Bundy v. Commercial Credit Corp.*, 202 N.C. 604, 163 S.E. 676 (1932) (return of



accounts for collection purposes). In addition, the privilege under the Code is some-

what more restricted as to type of collateral.

**§ 25-9-305. When possession by secured party perfects security interest without filing.**—A security interest in letters of credit and advices of credit (subsection (2)(a) of § 25-5-116), goods, instruments, negotiable documents or chattel paper may be perfected by the secured party's taking possession of the collateral. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this article. The security interest may be otherwise perfected as provided in this article before or after the period of possession by the secured party. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. As under the common law of pledge, no filing is required by this Article to perfect a security interest where the secured party has possession of the collateral. Compare Section 9—302(1) (a). This section permits a security interest to be perfected by transfer of possession only when the collateral is goods, instruments, documents or chattel paper: that is to say, accounts, contract rights and generally intangibles are excluded. See Section 5—116 for the special case of assignments of letters and advices of credit. A security interest in accounts, contract rights and general intangibles—property not ordinarily represented by any writing whose delivery operates to transfer the claim—may under this Article be perfected only by filing, and this rule would not be affected by the fact that a security agreement or other writing described the assignment of such collateral as a "pledge". Section 9—302(1) (e) exempts from filing certain assignments of accounts or contract rights which are out of the ordinary course of financing: such exempted assignments are perfected when they attach under Section 9—303 (1); they do not fall within this section.

2. Possession may be by the secured party himself or by an agent on his behalf: it is of course clear, however, that the debtor or a person controlled by him cannot qualify as such an agent for the secured party. See also the last sentence of Section 9—205. Where the collateral (except for goods covered by a negotiable document) is held by a bailee, the time of perfection of the security interest, under the second sentence of the section

is when the bailee receives notification of the secured party's interest: this rule rejects the common law doctrine that it is necessary for the bailee to attorn to the secured party or acknowledge that he now holds on his behalf.

3. The third sentence of the section rejects the "equitable pledge" theory of relation back, under which the taking possession was deemed to relate back to the date of the original security agreement. The relation back theory has had little vitality since the 1938 revision of the Federal Bankruptcy Act, which introduced in Section 60(a) provisions designed to make such interests voidable as preferences in bankruptcy proceedings. This section now brings state law into conformity with the overriding federal policy: where a pledge transaction is contemplated, perfection dates only from the time possession is taken, although a security interest may attach, unperfected, before that under the rules stated in Section 9—204. The only exception to this rule is the short twenty-one-day period of perfection provided in Section 9—304 (4) and (5), during which a debtor may have possession of specified collateral in which there is a perfected security interest.

**Cross references:**

Sections 5—116, 9—204, 9—302, 9—303 and 9—304.

**Definitional cross references:**

"Chattel paper". Section 9—105.

"Collateral". Section 9—105.

"Documents". Section 9—105.

"Goods". Section 9—105.

"Instruments". Section 9—105.

"Receives notification". Section 1—201.

"Secured party". Section 9—105.

"Security interest". Section 1—201.

#### NORTH CAROLINA COMMENT

The first sentence of this section is generally in accord with prior North Carolina

law to the effect that registration is not necessary to perfect a possessory security

interest. See North Carolina Comment to GS 25-9-301 (1).

The second sentence of this section abrogates the common-law rule that the bailee must acknowledge that he held the goods on behalf of the pledgee before the goods would be deemed to be in the possession of the pledgee. See Official Comments to this section. The North Carolina Supreme Court has apparently not dealt with this problem; but a federal district court has stated, where the collateral was in the possession of a third person, that "the . . . writing . . . might have become effective as a pledge to secure Lineberry if the writing had been delivered to the bank and if

the bank had agreed . . ." to hold the collateral for Lineberry. *United States v. Lucas*, 148 F. Supp. 768 (M.D.N.C. 1957). If this represented the North Carolina rule, the Code modifies it.

The third sentence rejects the concept of "equitable pledge." This probably changes North Carolina law. See *Godwin v. Murchinson Nat'l Bank*, 145 N.C. 320, 59 S.E. 154 (1907). However, the change is of little ultimate significance because the Federal Bankruptcy Act § 60 was amended in 1938 to make such interests generally voidable as preferences.

See the Official Comment to this section.

**§ 25-9-306. "Proceeds"; secured party's rights on disposition of collateral.**—(1) "Proceeds" includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. The term also includes the account arising when the right to payment is earned under a contract right. Money, checks and the like are "cash proceeds." All other proceeds are "non-cash proceeds."

(2) Except where this article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof by the debtor unless his action was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless

(a) a filed financing statement covering the original collateral also covers proceeds; or

(b) the security interest in the proceeds is perfected before the expiration of the ten-day period.

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest

(a) in identifiable non-cash proceeds;

(b) in identifiable cash proceeds in the form of money which is not commingled with other money or deposited in a bank account prior to the insolvency proceedings;

(c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a bank account prior to the insolvency proceedings; and

(d) in all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but the perfected security interest under this paragraph (d) is

(i) subject to any right of setoff; and

(ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings less the amount of cash proceeds received by the debtor and paid over to the secured party during the ten-day period.

(5) If a sale of goods results in an account or chattel paper which is transferred by the seller to a secured party, and if the goods are returned to or are repossessed by the seller or the secured party, the following rules determine priorities:

(a) If the goods were collateral at the time of sale for an indebtedness of the seller which is still unpaid, the original security interest attaches again to the goods

and continues as a perfected security interest if it was perfected at the time when the goods were sold. If the security interest was originally perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file.

(b) An unpaid transferee of the chattel paper has a security interest in the goods against the transferor. Such security interest is prior to a security interest asserted under paragraph (a) to the extent that the transferee of the chattel paper was entitled to priority under § 25-9-308.

(c) An unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under paragraph (a).

(d) A security interest of an unpaid transferee asserted under paragraph (b) or (c) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods. (1945, c. 196, s. 8; 1961, c. 574; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 10, Uniform Trust Receipts Act.

**Changes:** Modified and rewritten.

##### Purposes of changes:

1. To state a secured party's right to the proceeds received by a debtor on disposition of collateral and to state when his interest in such proceeds is perfected.

##### 2. Changes from prior law:

(a) Whether a debtor's sale of collateral was authorized or unauthorized, prior law generally gave the secured party a claim to the proceeds. Sometimes it was said that the security interest attached to the "property" received in substitution; sometimes it was said the debtor held the proceeds as "trustee" or "agent" for the secured party. Whatever the formulation of the rule, the secured party, if he could trace the proceeds, could reclaim them or their equivalent from the debtor or his trustee in bankruptcy. The change in existing law made by this section relates to non-identifiable cash proceeds; the secured party has, under conditions stated in subsection (4) (d), a security interest in the debtor's cash and bank accounts equal to the amount of cash proceeds received and commingled or deposited within the 10 days before insolvency proceedings were instituted less the amount of cash proceeds received by the debtor and paid over to the secured party during that period, without regard to whether or not the funds are identifiable as cash proceeds of the collateral.

(b) Subsections (2) and (3) make clear that the four-month period for calculating a voidable preference in bankruptcy begins with the date of the secured party's obtaining the security interest in the original collateral and not with the date of his obtaining control of the proceeds. The interest in the proceeds "continues"

as a perfected interest if the original interest was perfected; but the interest ceases to be perfected after the expiration of ten days unless the financing statement covering the original collateral covered the proceeds or unless the secured party perfects his interest in the proceeds themselves—i. e., by filing a financing statement covering them or by taking possession.

(c) Where cash proceeds are covered into the debtor's checking account and paid out in the operation of the debtor's business, recipients of the funds of course take free of any claim which the secured party may have in them as proceeds. What has been said relates to payments and transfers in ordinary course. The law of fraudulent conveyances would no doubt in appropriate cases support recovery of proceeds by a secured party from a transferee out of ordinary course or otherwise in collusion with the debtor to defraud the secured party.

3. In most cases when a debtor makes an unauthorized disposition of collateral, the security interest, under prior law and under this Article, continues in the original collateral in the hands of the purchaser or other transferee. That is to say, since the transferee takes subject to the security interest, the secured party may repossess the collateral from him or in an appropriate case maintain an action for conversion. Subsection (2) codifies this rule. The secured party may claim both proceeds and collateral, but may of course have only one satisfaction.

In many cases a purchaser or other transferee of collateral will take free of a security interest: in such cases the secured party's only right will be to proceeds. The transferee will take free whenever the disposition was authorized; the authori-



zation may be contained in the security agreement or otherwise given. A claim to proceeds in a filed financing statement might be considered as impliedly authorizing sale or other disposition of the collateral, depending upon the circumstances of the parties, the nature of the collateral, the course of dealing of the parties and the usage of trade (see Section 1—205). Section 9—301 states when transferees take free of unperfected security interests. Sections 9—307 on goods, 9—308 on chattel paper and non-negotiable instruments and 9—309 on negotiable instruments, negotiable documents and securities state when purchasers of such collateral take free of a security interest even though perfected and even though the disposition was not authorized.

4. Subsection (5) states rules to determine priorities when collateral which has been sold is returned to the debtor: for example goods returned to a department store by a dissatisfied customer. The most typical problems involve sale and return of inventory, but the subsection can also apply to equipment. Under the rule of *Benedict v. Ratner*, failure to segregate such returned goods sometimes led to invalidation of the entire security arrangement. This Article rejects the *Benedict v. Ratner* line of cases (see Section 9—205 and Comment). Subsection (5) (a) of this section reinforces the rule of Section 9—205: as between secured party and debtor (and debtor's trustee in bankruptcy) the original security interest continues on the returned goods. Whether or not the security interest in the returned goods is perfected depends upon factors stated in the text.

Subsections (5) (b), (c) and (d) deal with a different aspect of the returned goods situation. Assume that a dealer has sold an automobile and transferred the chattel paper or the account arising on the sale of Bank X (which had not previously financed the car as inventory). Thereafter the buyer of the automobile rightfully rescinds the sale, say for breach of warranty, and the car is returned to the dealer. Subsection (5) (b) gives the bank as transferee of the chattel paper or the account a security interest in the car against the dealer. For protection against the dealer's creditors or purchasers from him (other than buyers in the ordinary course of business, see Section 9—307), Bank X as the transferee, under subsection (5) (d), must perfect its interest by taking possession of the car or by filing as to it. Perfection of his original interest in the chattel paper or the account does

not automatically carry over to the returned car, as it does under subsection (5) (a) where the secured party originally financed the dealer's inventory.

In the situation covered by (5) (b) and (5) (c) a secured party who financed the inventory and a secured party to whom the chattel paper or the account was transferred may both claim the returned goods—the inventory financier under subsection (5) (a), the transferee under subsections (5) (b) and (5) (c). With respect to chattel paper, Section 9—308 regulates the priorities. With respect to an account, subsection (5) (c) subordinates the security interest of the transferee of the account to that of the inventory financier. However, if the inventory security interest was unperfected, the transferee's interest could become entitled to priority under the rules stated in Section 9—312(5).

In cases of repossession by the dealer and also in cases where the chattel was returned to the dealer by the voluntary act of the account debtor, the dealer's position may be that of a mere custodian; he may be an agent for resale, but without any other obligation to the holder of the chattel paper; he may be obligated to repurchase the chattel, the chattel paper or the account from the secured party or to hold it as collateral for a loan secured by a transfer of the chattel paper or the account.

If the dealer thereafter sells the chattel to a buyer in ordinary course of business in any of the foregoing cases, the buyer is fully protected under Section 2—403(2) as well as under Section 9—307(1), whichever is technically applicable.

#### Cross references:

Sections 9—307, 9—308 and 9—309.

Point 3: Sections 1—205 and 9—301.

Point 4: Sections 2—403(2), 9—205 and 9—312.

#### Definitive cross references:

"Account". Section 9—106.

"Bank". Section 1—201.

"Chattel paper". Section 9—105.

"Check". Sections 3—104 and 9—105.

"Collateral". Section 9—105.

"Contract right". Section 9—106.

"Creditors". Section 1—201.

"Debtor". Section 9—105.

"Goods". Section 9—105.

"Insolvency proceedings". Section 1—201.

"Money". Section 1—201.

"Purchaser". Section 1—201.

"Sale". Sections 2—106 and 9—105.

"Secured party". Section 9—105.

"Security agreement". Section 9—105.

"Security interest". Section 1—201.

## NORTH CAROLINA COMMENT

This section states the rules regarding a secured party's rights to proceeds and when he has a perfected security interest therein. The North Carolina cases have by implication recognized that a secured party can have some interest in the proceeds of the sale of the property, but it has never been expressly said that the interest is a "perfected security interest." See *Blanton Grocery Co. v. Taylor*, 162 N.C. 307, 78 S.E. 276 (1913). However, most courts have held that the mortgagee does have a security interest in the identifiable proceeds, at least where the mortgage provides that proceeds shall be applied to discharge the

mortgage. E.g., *Smith v. Swift & Co.*, 320 F.2d 268 (10th Cir. 1963). The Code gives the secured party a security interest proceeds in all cases, and in the event of insolvency of the debtor, the Code goes one step further in giving the secured party with a "perfected" security interest in proceeds a right to the nonidentifiable proceeds in the form of cash or bank accounts to an amount not greater than the amount of proceeds received by the debtor within ten days preceding the institution of the insolvency proceeding. See Official Comment to GS 25-9-306; GS 45-55 (trust receipts).

**§ 25-9-307. Protection of buyers of goods.**—(1) A buyer in ordinary course of business (subsection (9) of § 25-1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

(2) In the case of consumer goods and in the case of farm equipment having an original purchase price not in excess of twenty-five hundred dollars (\$2500.00) (other than fixtures, see § 25-9-313), a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes or his own farming operations unless prior to the purchase the secured party has filed a financing statement covering such goods. (1945, c. 182, s. 4; 1955, c. 386, s. 2; 1961, c. 574; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 9, Uniform Conditional Sales Act; Section 9(2), Uniform Trust Receipts Act.

**Changes:** Policy of prior acts continued (subsection (1)).

**Purposes of changes:**

1. This section states when buyers of goods take free of a security interest even though perfected. A buyer who takes free of a perfected security interest of course takes free of an unperfected one. Section 9—301 should be consulted to determine what purchasers, in addition to the buyers covered in this section, take free of an unperfected security interest.

Article 2 (Sales) states general rules on purchase of goods from a seller with defective or voidable title (Section 2—403).

2. The definition of "buyer in ordinary course of business" in Section 1—201(9) restricts the application of subsection (1) to buyers (except pawnbrokers) "from a person in the business of selling goods of that kind": thus the subsection applies, in the terminology of this Article, primarily to inventory. Subsection (1) further excludes from its operation buyers of "farm products", defined in Section 9—109(3), from a person engaged in farming opera-

tions. The buyer in ordinary course of business is defined as one who buys "in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party." This section provides that such a buyer takes free of a security interest, even though perfected, and although he knows the security interest exists. Reading the two provisions together, it results that the buyer takes free if he merely knows that there is a security interest which covers the goods but takes subject if he knows, in addition, that the sale is in violation of some term in the security agreement not waived by the words or conduct of the secured party.

The limitations which this section imposes on the persons who may take free of a security interest apply of course only to unauthorized sales by the debtor. If the secured party has authorized the sale in the security agreement or otherwise, the buyer takes free without regard to the limitations of this section. Section 9—306 states the right of a secured party to the proceeds of a sale, authorized or unauthorized.

3. Subsection (2) deals with buyers of "consumer goods" (defined in Section 9—

109) and with buyers of farm equipment having an original purchase price not in excess of \$2500. (If the consumer goods or farm equipment are fixtures, the rule of the subsection does not apply.) Under Section 9—302(1) (c) and (1) (d) no filing is required to perfect a purchase money interest in the consumer goods or farm equipment subject to this subsection except motor vehicles required to be licensed; filing is required to perfect security interests in such goods or equipment other than purchase money interests and, for motor vehicles, even in the case of purchase money interests.

Under subsection (2) a buyer of consumer goods or farm equipment takes free of a security interest even though perfected a) if he buys without knowledge of the security interest, b) for value, c) for his own personal, family or household purposes (or in the case of farm equipment for his own farming operations), and d) before a financing statement is filed.

*As to purchase money security interests which are perfected without filing under Section 9—302(1) (c) and (d):* A secured party may file a financing statement (although filing is not required for perfection). If he does file, all buyers take subject to the security interest. If he does not file, a buyer who meets the qualifications stated in the preceding paragraph takes free of the security interest.

As to security interests which can be perfected only by filing under Section 9—302: This category includes all non-purchase money interests, and all interests, whether or not purchase money, in motor vehicles, as well as interests which may be and are filed, though filing was not required for perfection under Section 9—302. (Note that under Section 9—

302(3) the filing provisions of this Article do not apply when a state has enacted a certain type of certificate of title law. Thus where motor vehicles are concerned, in a state having such a certificate of title law, perfection will be under that law.) So long as the security interest remains unperfected, not only the buyers described in subsection (2) but the purchasers described in Section 9—301 will take free of the interest. After a financing statement has been filed or after compliance with the certificate of title law all subsequent buyers, under the rule of subsection (2), are subject to the security interest.

*As to security interests in consumer goods or farm equipment which have become fixtures:* Since the rule of subsection (2) does not apply, the normal rules govern. Section 9—313 states rules of priority between a claimant of a chattel security interest in fixtures and persons who claim an interest in the fixtures as realty.

#### Cross references:

Point 1: Sections 2—403 and 9—301.

Point 2: Section 9—306.

Point 3: Sections 9—301, 9—302 and 9—313.

#### Definitional cross references:

"Buyer in ordinary course of business".

Section 1—201.

"Consumer goods". Section 9—109.

"Equipment". Section 9—109.

"Farm products". Section 9—109.

"Goods". Section 9—105.

"Knows" and "Knowledge". Section 1—201.

"Person". Section 1—201.

"Purchase". Section 1—201.

"Secured party". Section 9—105.

"Security interest". Section 1—201.

"Value". Section 1—201.

### NORTH CAROLINA COMMENT

In North Carolina a buyer in the ordinary course of business could be assured of having rights superior to those of a holder of a security interest in the goods in only three situations: (1) Where he purchased from a merchant whose merchandise was financed under a trust receipt pursuant to the Uniform Trust Receipts Act, GS 45-54; (2) where he purchased from a manufacturer or processor whose goods were subject to a security interest created by a factor's lien, GS 44-73; and (3) when he purchased an automobile from a dealer, GS 20-58.9. In all other situations, the buyer in the ordinary course took subject to the previous security interest unless the secured party had given an express power of dis-

position to the debtor or unless the conduct and dealing between the debtor and the secured party was such as to give rise to an inference that the secured party had waived his lien. *Atlantic Discount Corp. v. Young*, 224 N.C. 89, 29 S.E.2d 29 (1944); *Southern Ry. v. W. A. Simpkins Co.*, 178 N.C. 273, 100 S.E. 418 (1919). Proof that the mortgagee permitted the mortgagor to keep the goods in his possession and display them at the mortgagor's place of business was not sufficient evidence of waiver of the lien. *Whitehurst v. Garrett*, 196 N.C. 154, 144 S.E. 835 (1928); *State Trust Co. v. M. & J. Fin. Corp.*, 238 N.C. 478, 78 S.E.2d 327 (1953). However, where the above facts were present and the mortgagor



was not required by the mortgagee to satisfy the underlying obligation before sale of the goods, the buyer in ordinary course would prevail over the previous security interest. *Atlantic Discount Corp. v. Young*, 224 N.C. 89, 29 S.E.2d 29 (1944). The Code extends protection to all buyers in the ordinary course as defined in GS 25-1-201 (9). Thus, North Carolina law is to some extent changed by this section, but the ef-

fect is only to equalize the status of all buyers in the ordinary course of business. Subsection (2) changes existing law, in that a purchaser in the circumstances set out in the Code could not prevail over a "perfected" security interest. See North Carolina Comment to GS 25-9-301 (1). However, the significance of the change is more theoretical than factual.

**§ 25-9-308. Purchase of chattel paper and nonnegotiable instruments.**—A purchaser of chattel paper or a nonnegotiable instrument who gives new value and takes possession of it in the ordinary course of his business and without knowledge that the specific paper or instrument is subject to a security interest has priority over a security interest which is perfected under § 25-9-304 (permissive filing and temporary perfection). A purchaser of chattel paper who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in chattel paper which is claimed merely as proceeds of inventory subject to a security interest (§ 25-9-306), even though he knows that the specific paper is subject to the security interest. (1961, c. 574; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 9(a) and 10 of Uniform Trust Receipts Act.

**Changes:** Important changes in substance.

##### Purposes of changes:

1. Chattel paper is defined (Section 9—105) as "a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods". In terms of existing security devices the definition covers, for example, the conditional sale contract, the bailment lease and the chattel mortgage. Such paper has become an important class of collateral in financing arrangements, which may—as in the automobile and some other fields—follow an earlier financing arrangement covering inventory or which may begin with the chattel paper itself.

Arrangements where the chattel paper is delivered to the secured party who then makes collections, as well as arrangements where the debtor, whether or not he is left in possession of the paper, makes the collections, are both widely used, and are known respectively as notification (or "direct collection") and non-notification (or "indirect collection") arrangements. In the automobile field, for example, when a car is sold to a consumer buyer under an installment purchase agreement and the resulting chattel paper is assigned, the assignee usually takes possession, the obligor is notified of the assignment and is directed to make payments to the assignee. In the furniture field, for an example on the other hand, the chattel paper may be left in the dealer's

hands or delivered to the assignee; in either case the obligor is usually not notified, and payments are made to the dealer-assignor who receives them under a duty to remit to his assignee. The widespread use of both methods of dealing with chattel paper is recognized by the provisions of this Article which permit perfection of a chattel paper security interest either by filing or by taking possession.

2. Although perfection by filing is permitted as to chattel paper, certain purchasers of chattel paper allowed to remain in the debtor's possession take free of the security interest despite the filing. The second sentence of the section deals with the case where the security interest in the chattel paper is claimed merely as proceeds—i. e. in favor of an inventory financier, whether or not his filed financing statement claimed proceeds, who has not by some new transaction with the debtor acquired a specific interest in the chattel paper. In that case a purchaser, even though he knows of the inventory financier's proceeds interest, takes priority provided he gives new value and takes possession of the paper in the ordinary course of his business. The first sentence deals with the case where the non-possessory security interest in the chattel paper is more than a mere claim to proceeds—i. e. exists in favor of a secured party who has given value against the paper, whether or not he financed the inventory whose sale gave rise to it. In this case the purchaser, to take priority, must not only give new value and take possession in

the ordinary course of his business; he must also take without knowledge of the existing security interest. Thus a secured party, who has a specific interest in the chattel paper and not merely a claim to proceeds, and who wishes to leave the paper in the debtor's possession can, because of the knowledge requirement, protect himself against purchasers by stamping or noting on the paper the fact that it has been assigned to him.

3. The rule of the first sentence of the section also applies to non-negotiable instruments. Note that the term "non-negotiable instrument" is by no means as broad as the common law concept of "choses in action": accounts, contract rights and general intangibles (all defined in Section 9-106) are not included. It should also be noted that under Section 9-304(1) a security interest in an instrument, negotiable or non-negotiable, cannot be perfected by filing. Thus the only type of perfected non-possessory security interest that can arise in an instrument is the temporary 21 day perfect-

tion provided for in Section 9-304(4) and (5). Where such a perfected interest exists in a non-negotiable instrument, purchasers will take free if they qualify under the first sentence of the section. Since the second sentence applies only to chattel paper, knowledge of the existing security interest would defeat the purchaser of a non-negotiable instrument even though that interest was claimed merely as proceeds.

**Cross references:**

Point 1: Sections 9-304(1) and 9-305(1).

Point 2: Section 9-306.

Point 3: Section 9-304.

**Definitional cross references:**

"Chattel paper". Section 9-105.

"Instrument". Section 9-105.

"Inventory". Section 9-109.

"Knowledge". Section 1-201.

"Proceeds". Section 9-306.

"Purchaser". Section 1-201.

"Security interest". Section 1-201.

"Value". Section 1-201.

**§ 25-9-309. Protection of purchasers of instruments and documents.**

—Nothing in this article limits the rights of a holder in due course of a negotiable instrument (§ 25-3-302) or a holder to whom a negotiable document of title has been duly negotiated (§ 25-7-501) or a bona fide purchaser of a security (§ 25-8-301) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this article does not constitute notice of the security interest to such holders or purchasers. (1961, c. 574; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 9(a), Uniform Trust Receipts Act.

**Changes:** No changes in substance.

**Purposes:**

1. Under this Article as at common law and under prior statutes the rights of purchasers of negotiable paper, including negotiable documents of title and investment securities, are determined by the rules of holding in due course and the like which are applicable to the type of paper concerned. (Articles 3, 7, and 8.) This section, as did Section 9(a) of the Uniform Trust Receipts Act, makes explicit the rule which was implicitly but universally recognized under earlier statutes.

2. Under Section 9-304(1) filing is ineffective to perfect a security interest in instruments (including securities) and of course is ineffective to constitute notice to subsequent purchasers. Although filing is permissible as a method of perfection

for a security interest in documents, this Section follows the policy of the Uniform Trust Receipts Act in providing that the filing does not constitute notice to purchasers.

**Cross references:**

Articles 3, 7, and 8 and Section 9-304(1).

**Definitional cross references:**

"Bona fide purchaser". Section 8-302.

"Document of title". Section 1-201.

"Duly negotiated". Section 7-501.

"Holder". Section 1-201.

"Holder in due course". Sections 3-302 and 9-105.

"Negotiable instrument". Sections 3-104 and 9-105.

"Notice". Section 1-201.

"Purchaser". Section 1-201.

"Security". Sections 8-102 and 9-105.

"Security interest". Section 1-201.

**NORTH CAROLINA COMMENT**

This section is in accord with the Uniform Trust Receipts Act, GS 45-54 (a), in giving priority to the purchaser for value of negotiable instruments or documents of

title left in the possession of the debtor, even though the security interest has been perfected by filing.

**§ 25-9-310. Priority of certain liens arising by operation of law.**—When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 11, Uniform Trust Receipts Act.

**Changes:** None in substance.

**Purposes:**

1. To provide that liens securing claims arising from work intended to enhance or preserve the value of the collateral take priority over an earlier security interest even though perfected.

2. Apart from the Uniform Trust Receipts Act which had a section similar to this one, there was generally no specific statutory rule as to priority between security devices and liens for services or materials. Under chattel mortgage or conditional sales law many decisions made the priority of such liens turn on whether the secured party did or did not have "title". This section changes such rules and makes the lien for services or materials prior in all cases where they

are furnished in the ordinary course of the lienor's business and the goods involved are in the lienor's possession. Some of the statutes creating such liens expressly make the lien subordinate to a prior security interest. This section does not repeal such statutory provisions. If the statute creating the lien is silent, even though it has been construed by decision to make the lien subordinate to the security interest, this section provides a rule of interpretation that the lien should take priority over the security interest.

**Cross references:**

Sections 9—102(2), 9—104(c) and 9—312(1).

**Definitional cross references:**

"Goods". Section 9—105.

"Person". Section 1—201.

"Security interest". Section 1—201.

#### NORTH CAROLINA COMMENT

This section preserves the priority of common-law and statutory possessory liens, unless the statute giving the lien provides otherwise. Thus, the North Carolina statutory liens afforded persons who make repairs to personal property, GS 44-2, the warehouse storage liens, GS 44-28 and 44-29, liens given to hotel keepers and livery stable keepers will probably prevail over a Code-perfected security interest so long as the person entitled to the lien retains pos-

session of the property. This is in accord with prior law, at least insofar as it relates to the lien for repairs to personal property. See *Johnson v. Yates*, 183 N.C. 24, 110 S.E. 630 (1922). Other liens of this class which do not involve possession of the person claiming the lien are probably subordinated to the Code-perfected security interest. At least, they are not entitled to priority by virtue of this section.

**§ 25-9-311. Alienability of debtor's rights; judicial process.**—The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of a security interest, attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. To make clear that in all security transactions under this Article, the debtor has an interest (whether legal title or an equity) which he can dispose of and which his creditors can reach.

2. Some jurisdictions have held that when a mortgagee or conditional seller has "title" to the collateral, creditors may not proceed against the mortgagor's or vendee's interest by levy, attachment or other judicial process. This section changes

those rules by providing that in all security interests the debtor's interest in the collateral remains subject to claims of creditors who take appropriate action. It is left to the law of each state to determine the form of "appropriate process."

3. Where the security interest is in inventory, difficult problems arise with reference to attachment and levy. Assume that a debt of \$100,000 is secured by inventory worth twice that amount. If by attachment or levy certain units of the inventory are seized, the determination



of the debtor's equity in the units seized is not a simple matter. The section leaves the solution of this problem to the courts. Procedures such as marshalling may be appropriate.

**Definitional cross references:**

"Collateral". Section 9—105.

"Debtor". Section 9—105.

"Rights". Section 1—201.

"Sale". Sections 2—106 and 9—105.

"Security agreement". Section 9—105.

"Security interest". Section 1—201.

**NORTH CAROLINA COMMENT**

With regard to involuntary transfer such as levy under execution and attachment, this section is in accord with prior law. GS 1-315 and 1-440.4.

**§ 25-9-312. Priorities among conflicting security interests in the same collateral.**—(1) The rules of priority stated in the following sections shall govern where applicable: § 25-4-208 with respect to the security interest of collecting banks in items being collected, accompanying documents and proceeds; § 25-9-301 on certain priorities; § 25-9-304 on goods covered by documents; § 25-9-306 on proceeds and repossessions; § 25-9-307 on buyers of goods; § 25-9-308 on possessory against non-possessory interests in chattel paper or non-negotiable instruments; § 25-9-309 on security interests in negotiable instruments, documents or securities; § 25-9-310 on priorities between perfected security interests and liens by operation of law; § 25-9-313 on security interests in fixtures as against interests in real estate; § 25-9-314 on security interests in accessions as against interests in goods; § 25-9-315 on conflicting security interests where goods lose their identity or become part of a product; and § 25-9-316 on contractual subordination.

(2) A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.

(3) A purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the collateral; and

(b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same items of [or] type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and

(c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

(4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.

(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined as follows:

(a) in the order of filing if both are perfected by filing, regardless of which security interest attached first under § 25-9-204(1) and whether it attached before or after filing;

(b) in the order of perfection unless both are perfected by filing, regardless of

which security interest attached first under § 25-9-204(1) and, in the case of a filed security interest, whether it attached before or after filing; and

(c) in the order of attachment under § 25-9-204(1) so long as neither is perfected.

(6) For the purpose of the priority rules of the immediately preceding subsection, a continuously perfected security interest shall be treated at all times as if perfected by filing if it was originally so perfected and it shall be treated at all times as if perfected otherwise than by filing if it was originally perfected otherwise than by filing. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C. S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 196, s. 4; 1955, c. 816; 1957, c. 999; 1965, c. 700, s. 1.)

**Editor's Note.** — The word "or" in brackets in paragraph (b) of subsection (3) is suggested as a correction of "of," which appears in the 1965 Session Laws.

**Precedence of Agricultural Lien over Prior Mortgage Lien.** — An agricultural lien duly executed and registered took pre-

cedence over a mortgage of prior date and registration upon the "crops" therein subjected to the extent of the advances made. *Wooten v. Hill*, 98 N.C. 48, 3 S.E. 846 (1887); *Killebrew v. Hines*, 104 N.C. 182, 10 S.E. 159 (1889). But see *Brewer v. Chappell*, 101 N.C. 251, 7 S.E. 670 (1888).

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. In a variety of situations two or more people may claim an interest in the same property. The several sections listed in subsection (1) state rules for determining priorities between security interests and such other claims in the situations covered in those sections. For cases not covered in those sections this section states general rules of priority between conflicting security interests.

2. Subsection (2) gives priority to a new value security interest in crops based on a current crop production loan over an earlier security interest in the crop which secured obligations (such as rent, interest or mortgage principal amortization) due more than six months before the crops become growing crops. This priority is not affected by the fact that the person making the crop loan knew of the earlier security interest. Section 9—204(4) (a) should be consulted on the extent to which this Article permits a security interest to attach to crops planted after the execution of the security agreement.

3. Subsections (3) and (4) give priority to a purchase money security interest (defined in Section 9—107) under certain conditions over non-purchase money interests, which in this context will usually be interests asserted under after-acquired property clauses. See Section 9—204(3) and (4) on the extent to which after-acquired property interests are validated and Section 9—108 on when a security interest in after-acquired property is deemed taken for new value.

Prior law, under one or another theory,

usually contrived to protect purchase money interests over after-acquired property interests (to the extent to which the after-acquired property interest was recognized at all). For example, in the field of industrial equipment financing it was possible, by manipulation of title theory, for the purchase money financier of new equipment (under conditional sale or equipment trust) to protect himself against the claims of prior mortgagees or bondholders under an after-acquired clause in the mortgage or trust indenture: the result was arrived at on the theory that since "title" to the equipment was never in the vendee or lessee there was nothing for the lien of the mortgage to attach to. While this Article broadly validates the after-acquired property interest, it also recognizes as sound the preference which prior law gave to the purchase money interest. That policy is carried out in subsections (3) and (4).

Subsection (4) states a general rule applicable to all types of collateral except inventory: the purchase money interest takes priority provided only that it is perfected when the debtor receives possession of the collateral or within ten days thereafter. As to the ten day grace period, compare Section 9—301(2). The perfection requirement means that the purchase money secured party either has filed a financing statement before that time or has a temporarily perfected interest in goods covered by documents under Section 9—304(4) and (5) (which is continued in a perfected status by filing before the expiration of the 21 day period specified in that section). There is no requirement that the purchase money secured party be without notice or knowledge of the

other interest; he takes priority although he knows of it or it has been filed.

Under subsection (3) the same rule of priority, but without the ten day grace period for filing, applies to a purchase money security interest in inventory with the additional requirement that the purchase money secured party give notification, as stated in subsections (3) (b) and (3) (c), to any other secured party of whom he knows or who was the first to file and who is also interested in the same item or type of inventory. The reason for the additional requirement of notification is that typically the arrangement between an inventory secured party and his debtor will require the secured party to make periodic advances against incoming inventory or periodic releases of old inventory as new inventory is received. A fraudulent debtor may apply to the secured party for advances even though he has already given a security interest in the inventory to another secured party. The notification requirement protects the inventory financier in such a situation: if he has received notification, he will presumably not make an advance; if he has not received notification (or if the other interest does not qualify as a purchase money interest), any advance he may make will have priority. Since an arrangement for periodic advances against incoming property is unusual outside the inventory field, no notification requirement is included in subsection (4).

4. Subsection (5) states rules for determining priority between conflicting security interests in cases not covered in the sections listed in subsection (1) or in subsections (2), (3) and (4) of this section. Note that subsection (5) applies to cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4).

The operation of subsections (5) and (6) is illustrated by the following examples.

**Example 1.** A files against X (debtor) on February 1. B files against X on March 1. B makes a non-purchase money advance against certain collateral on April 1. A makes an advance against the same collateral on May 1. A has priority even though B's advance was made earlier and was perfected when made. It makes no difference whether or not A knew of B's interest when he made his advance.

The problem stated in the example is peculiar to a notice filing system under which filing may be made before the security interest attaches (see Section 9—

402). The Uniform Trust Receipts Act, which first introduced such a filing system, contained no hint of a solution and case law under it has been unpredictable. This Article follows several of the accounts receivable statutes in determining priority by order of filing. The justification for the rule lies in the necessity of protecting the filing system—that is, of allowing the secured party who has first filed to make subsequent advances without each time having, as a condition of protection, to check for filings later than his. Note, however, that his protection is not absolute: if, in the example, B's advance creates a purchase money security interest, he has priority under subsection (4), or, in the case of inventory, under subsection (3) provided he has properly notified A. (See further Example 3 below.)

**Example 2.** A and B make non-purchase money advances against the same collateral. The collateral is in the debtor's possession and neither interest is perfected when the second advance is made. Whichever secured party first perfects his interest (by taking possession of the collateral or by filing) takes priority and it makes no difference whether or not he knows of the other interest at the time he perfects his own.

Subsections (5) (a) and (5) (b) both lead to this result. It may be regarded as an adoption, in this type of situation, of the idea, deeply rooted at common law, of a race of diligence among creditors. Subsection (5) (c) adds the thought that so long as neither of the interests is perfected, the one which first attached (i. e. under the advance first made) has priority. The last mentioned rule may be thought to be of merely theoretical interest, since it is hard to imagine a situation where the case would come into litigation without either A or B having perfected his interest. If neither interest had been perfected at the time of the filing of a petition in bankruptcy, of course neither would be good against the trustee in bankruptcy.

**Example 3.** A has a temporarily perfected (21 day) security interest, unfiled, in a negotiable document in the debtor's possession under Section 9—304 (4) or (5). On the fifth day B files and thus perfects a security interest in the same document. On the tenth day A files. A has priority, whether or not he knows of B's interest when he files.

The result follows from subsection (6) which classifies security interests according to the manner of their initial perfection. The case therefore falls under sub-



section (5) (b) and not under (5) (a); A prevails because his interest was first perfected although B was first to file.

**Example 4.** On February 1 A makes an advance against machinery in the debtor's possession and files his financing statement. On March 1 B makes an advance against the same machinery and files his financing statement. On April 1 A makes a further advance, under the original security agreement, against the same machinery (which is covered by the original financing statement and thus perfected when made). A has priority over B both as to the February 1 and as to the April 1 advance and it makes no difference whether or not A knows of B's intervening advance when he makes his second advance.

The case falls under subsection (5) (a), since both interests are perfected by filing. A wins, as to the April 1 advance, because he first filed even though B's interest attached, and indeed was perfected, first. Section 9-204(5) and the Comment thereto should be consulted for the validation of future advances. Section 9-313 provides for cases involving fixtures.

**Example 5.** On February 1 A makes advances to X under a security agreement which covers "all the machinery in X's plant" and contains an after-acquired property clause. A promptly files his financing statement. On March 1 X acquires a new machine. B makes an advance against it and files his financing statement. On April 1 A, under the original security agreement, makes an advance against the machine acquired March 1. If B's advance creates a purchase money

security interest, he has priority under subsection (4) (provided he filed before X received possession of the machine or within ten days thereafter). If B's advance, although he gave new value, did not create a purchase money interest, A has priority for the reasons stated under Example 4.

#### Cross references:

Sections 9-204(1) and 9-303.

Point 1: Sections 4-208, 9-301, 9-304, 9-306, 9-307, 9-308, 9-309, 9-310, 9-313, 9-314, 9-315 and 9-316.

Point 2: Section 9-204(4) (a).

Point 3: Sections 9-108, 9-204(3) and (4), 9-304(4) and (5).

Point 4: Sections 9-204(5), 9-304(4) and (5) and 9-402(1).

#### Definitional cross references:

"Bank". Section 1-201.

"Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Debtor". Section 9-105.

"Documents". Section 9-105.

"Give notice". Section 1-201.

"Goods". Section 9-105.

"Instruments". Section 9-105.

"Inventory". Section 9-109.

"Knowledge". Section 1-201.

"Person". Section 1-201.

"Proceeds". Section 9-306.

"Purchase money security interest". Section 9-107.

"Receives" notification. Section 1-201.

"Secured party". Section 9-105.

"Security". Sections 8-102 and 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

### NORTH CAROLINA COMMENT

This section should be read with the other sections of the Code set out in subsection (1) to determine the overall priority of a security interest created under article 9. GS 25-9-312 deals only with competing consensual security interests in the same property.

*Subsection (2)* is new. However, like the North Carolina statute governing liens on crops for advances, GS 44-52, this section does give a preferred status to security interests arising from giving new value to enable the debtor to produce the crops. The protection afforded the person making advances under the Code is not, however, as complete as the protection given under prior law. A lien on crops had priority over all other security interests in the crops with the exception of the liens of landlords and laborers, and an earlier registered lien for advances. GS

44-52. See also *Rhodes v. Smith-Douglass Fertilizer Co.*, 220 N.C. 21, 16 S.E.2d 408 (1941); *Eastern Cotton Oil Co. v. Powell*, 201 N.C. 351, 160 S.E. 292 (1931). The UCC gives priority over previous encumbrances only to the extent that the debts secured by such encumbrances had matured more than six months prior to planting of the crops. The security interest in crops is also subordinated to the landlord's lien, GS 42-15. See North Carolina Comment to GS 25-9-104 (b). The status under the Code of the laborer's lien, GS 44-1 and 44-41, is not clear. Generally, the laborer's lien has priority only over encumbrances created after the beginning of the work. GS 44-41. It is not, as is the landlord's lien, individually excluded from the operation of article 9 without reference to priority. GS 25-9-104 (b). Therefore, the laborer's lien would appear to

fall within that class of liens excluded by GS 25-9-104 (c), wherein reference is made to GS 25-9-310 for priority. The laborer's lien is not a possessory lien and probably would not be entitled to the automatic priority given in GS 25-9-310 to possessory liens. As a result, the laborer's lien might not be entitled to priority over the crop lien, at least where the crop lien antedates the beginning of the work.

*Subsection (3)* is new and to the extent of its coverage it changes North Carolina law. The provision is designed to protect the holder of a "floating lien" on inventory, who will normally make advances on the incoming inventory of the debtor, from subordination to purchase money security interests without notice. The provision is designed to enable the holder of a "floating lien" on inventory to have notice that his security interest is being depleted by subordination to purchase money security interests, so that he will not make advances on collateral which he cannot acquire a superior interest in. If notice is not given by the holder of the purchase money security interest as required in subsections (3) (b) and (3) (c), the "floating lien" will have priority. Under prior law, the holder of the purchase money security interest would probably have had priority in all cases. See North Carolina Comment to subsection (4), *infra*.

*Subsection (4)* is generally in accord with North Carolina law, with the exception of the ten-day "grace" period within which to perfect the security interest. Under prior law, the purchase money security interest had priority over previously registered security interest. *Standard Dry Kiln Co. v. Ellington*, 172 N.C. 481, 90 S.E. 564 (1916); *Cox v. New Bern Lighting & Fuel Co.*, 151 N.C. 62, 65 S.E. 648 (1909). But see *Hickson Lumber Co. v.*

*Gay Lumber Co.*, 150 N.C. 282, 63 S.E. 1045 (1909). There is one change in law. The Code requires that the purchase money security interest be perfected within ten days after the debtor receives possession of the collateral to qualify for the priority. Heretofore, the North Carolina court has stated that the purchase money interest would prevail even though it was never registered or "perfected" because the registration statutes are for the protection of subsequent, not prior, purchasers and creditors. *Cox v. New Bern Lighting & Fuel Co.*, 151 N.C. 62, 65 S.E. 648 (1909).

*Subsection (5)* is generally in accord with North Carolina law. The first security interest registered prevailed even though it was not the first executed. See, e.g., *Commercial Inv. Trust v. Albemarle Motor Co.*, 193 N.C. 663, 137 S.E. 874 (1927) (registered chattel mortgage prevails over unregistered conditional sales contract on same property). Accord: GS 44-80 (3) (assignments of accounts receivable). Likewise, where a mortgagee had perfected the security interest by taking possession of the collateral, he should prevail over a subsequently registered mortgagee, covering the same collateral. Cf. *McCreary Tire & Rubber Co. v. Crawford*, 253 N.C. 100, 116 S.E.2d 491 (1960).

The last phrases of subsections (5) (a) and (5) (b) give priority to the first security interest filed, even though the debtor does not have rights in the property at the time of filing (or if for some other reason the security interest has not "attached" under GS 25-9-204 (1)). The North Carolina law on this point was uncertain. See North Carolina Comment to GS 25-9-303.

*Subsection (6)* reaffirms the rule of continuous perfection set out in GS 25-9-303.

**§ 25-9-313. Priority of security interests in fixtures.**—(1) The rules of this section do not apply to goods incorporated into a structure in the manner of lumber, bricks, tile, cement, glass, metal work and the like and no security interest in them exists under this article unless the structure remains personal property under applicable law. The law of this State other than this chapter determines whether and when other goods become fixtures. This chapter does not prevent creation of an encumbrance upon fixtures or real estate pursuant to the law applicable to real estate.

(2) A security interest which attaches to goods before they become fixtures takes priority as to the goods over the claims of all persons who have an interest in the real estate except as stated in subsection (4).

(3) A security interest which attaches to goods after they become fixtures is valid against all persons subsequently acquiring interests in the real estate except as stated in subsection (4) but is invalid against any person with an interest in the real estate at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as fixtures.

(4) The security interests described in subsections (2) and (3) do not take priority over

(a) a subsequent purchaser for value of any interest in the real estate; or

(b) a creditor with a lien on the real estate subsequently obtained by judicial proceedings; or

(c) a creditor with a prior encumbrance of record on the real estate to the extent that he makes subsequent advances

if the subsequent purchase is made, the lien by judicial proceedings is obtained, or the subsequent advance under the prior encumbrance is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the real estate at a foreclosure sale other than an encumbrancer purchasing at his own foreclosure sale is a subsequent purchaser within this section.

Any provision in this article to the contrary notwithstanding, a security interest is perfected against real estate within the meaning of subsection (4) of this section and all other provisions of this article only when the filing or recording of an instrument with respect to such security interest is filed in the county where such real estate is located, and the register of deeds shall file or record the same in accordance with the requirements which he is required to observe with respect to the filing or recording of mortgages on real estate under the laws of this State.

(5) When under subsections (2) or (3) and (4) a secured party has priority over the claims of all persons who have interests in the real estate, he may, on default, subject to the provisions of part 5, remove his collateral from the real estate but he must reimburse any encumbrancer or owner of the real estate who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 7, Uniform Conditional Sales Act.

**Changes:** Changed in substance.

**Purposes of changes:**

1. To state when a secured party claiming an interest in goods as fixtures under this Act is entitled to priority over a person claiming an interest in the same goods by reason of the law applicable to real estate.

2. This section, like Section 7 of the Uniform Conditional Sales Act, leaves it to other law to determine when chattels become realty by affixation except to the extent that the first sentence of subsection (1) makes clear that the section does not apply to structural materials.

3. Where a security interest in the goods as chattels has attached before affixation, subsection (2) gives the secured party priority over all prior claims based on an interest in the realty. If the secured party perfects his interest by filing, which he may do in advance of affixation, he takes priority over subsequent realty claims as well. So long as he fails to perfect his interest he may, however, be subordinated to the subsequent claimants described in subsections (4) (a), (b) and

(c). The last sentence of subsection (4) on purchasers at foreclosure sales clarifies a point on which prior decisions have been in conflict.

4. Subsection (3) permits a chattel interest to be taken in goods after they have become fixtures. In this case the secured party has the same rights against subsequent real estate interests as when his interest was taken before affixation. However the post-affixation security interest is invalid against prior real estate claims unless they agree in writing to a subordinate status. The reason for the distinction taken, as to prior real estate claims, between the pre-affixation and post-affixation security interest is that in the former case the value of the real estate is presumably being increased by the addition of the fixture, while in the latter case value, on which the real estate encumbrancer may have counted, is being in a sense deducted from the real estate by the separate financing of a part of it as a fixture.

5. Subsection (5) is an important departure from Section 7 of the Uniform Conditional Sales Act and from much other conditional sales legislation. Under



the Uniform Conditional Sales Act a conditional vendor could not sever and remove the affixed chattel if a "material injury to the freehold" would result. The courts of various jurisdictions were in sharp disagreement on the meaning of "material injury": some held that only physical injury was meant; others adopted the so-called "institutional theory" and denied removal whenever the "going value" of the structure would be materially diminished by the removal. Under these rules the conditional vendor either could not remove at all, or, if he could, could damage the structure on removal without becoming accountable to the real estate claimant. The situation was complicated by the fact that it became increasingly difficult to predict what types of goods the courts in a given jurisdiction would hold not subject to removal.

Subsection (5) abandons the "material injury to the freehold" rule. Instead a secured party entitled to priority may in all cases sever and remove his collateral, subject, however, to a duty to reimburse any real estate claimant (other than the debtor himself) for any physical injury caused by the removal. The right to reimbursement is implemented by the last sentence of subsection (5) which gives the real estate claimant a statutory right to security or indemnity, failing which he may refuse permission to remove. The subsection (5) rule thus accomplishes two

things: it puts an end to the uncertainty which has grown up under the "material injury" rule, while at the same time it protects the real estate claimant under the reimbursement provisions.

6. Under this Article as under the Uniform Conditional Sales Act the place of filing with respect to goods affixed or to be affixed to realty is with the real estate records and not with the chattel records. See Section 9-401 on the place of filing and Section 9-402 on the form of financing statement.

**Cross references:**

Sections 9-102(1), 9-104(j) and 9-312(1).

Point 3: Sections 9-204(1), 9-303 and 9-402(1).

Point 5: Part 5.

Point 6: Sections 9-401(1) (b) and 9-402.

**Definitional cross references:**

"Collateral". Section 9-105.

"Contract". Section 1-201.

"Creditor". Section 1-201.

"Debtor". Section 9-105.

"Goods". Section 9-105.

"Knowledge". Section 1-201.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Purchaser". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

"Writing". Section 1-201.

### NORTH CAROLINA COMMENT

As to a security interest which attaches to the goods before they become fixtures, this section is generally in accord with prior North Carolina law. In *Cox v. New Bern Lighting & Fuel Co.*, 151 N.C. 62, 65 S.E. 648 (1909) the court stated: "One holding a mortgage on the realty has no equitable claim to chattels subsequently annexed to it. He has parted with nothing on the faith of such chattels. Therefore, the title of a conditional vendor of such chattels, or of a mortgagee of them before the time they were attached to the realty, is just as good against mortgagee of the realty as it is against the mortgagor."

However, in *Standard Motors Fin. Co. v. Weaver*, 199 N.C. 178, 153 S.E. 861 (1930), the court held that a subsequent pur-

chaser of the real estate at a foreclosure sale could not prevail over the mortgagee of a sprinkler system installed in the building. That case is contra to subsection (4).

Subsection (5) gives a party who holds a security interest in fixtures which is entitled to priority the absolute right to remove the fixtures, subject to his duty to reimburse the landowner for any loss suffered thereby. This is a departure from the generally recognized rule that the chattel mortgage will be subordinated where the fixture "cannot be removed without diminishing or impairing an existing mortgage . . ." on the real estate. *Cox v. New Bern Lighting & Fuel Co.*, 151 N.C. 62, 65 S.E. 648 (1909).

**§ 25-9-314. Accessions.**—(1) A security interest in goods which attaches before they are installed in or affixed to other goods takes priority as to the goods installed or affixed (called in this section "accessions") over the claims of all persons to the whole except as stated in subsection (3) and subject to § 25-9-315(1).

(2) A security interest which attaches to goods after they become part of a whole is valid against all persons subsequently acquiring interests in the whole ex-

cept as stated in subsection (3) but is invalid against any person with an interest in the whole at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as part of the whole.

(3) The security interests described in subsections (1) and (2) do not take priority over

(a) a subsequent purchaser for value of any interest in the whole; or

(b) a creditor with a lien on the whole subsequently obtained by judicial proceedings; or

(c) a creditor with a prior perfected security interest in the whole to the extent that he makes subsequent advances

if the subsequent purchase is made, the lien by judicial proceedings obtained or the subsequent advance under the prior perfected security interest is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the whole at a foreclosure sale other than the holder of a perfected security interest purchasing at his own foreclosure sale is a subsequent purchaser within this section.

(4) When under subsections (1) or (2) and (3) a secured party has an interest in accessions which has priority over the claims of all persons who have interests in the whole, he may on default subject to the provisions of part 5 remove his collateral from the whole but he must reimburse any encumbrancer or owner of the whole who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

1. To state when a secured party claiming an interest in goods installed in or affixed to other goods is entitled to priority over a party with a security interest in the whole.

2. This section changes prior law in that the secured party claiming an interest in a part (e. g., a new motor in an old car) is entitled to priority and has a right to remove even though under other rules of law the part now belongs to the whole. The section adopts the same policy as that stated in Section 9—313 for fixtures.

3. This section does not apply to goods which, for example, are so commingled in a manufacturing process that their original identity is lost. That type of situation is covered in Section 9—315. Section 9—315 should also be consulted for the effect

of a financing statement which claims both component parts and the resulting product.

**Cross references:**

Sections 9—204(1), 9—303 and 9—312(1) and Part 5.

Point 2: Section 9—313.

Point 3: Section 9—315.

**Definitional cross references:**

"Collateral". Section 9—105.

"Creditor". Section 1—201.

"Debtor". Section 9—105.

"Goods". Section 9—105.

"Knowledge". Section 1—201.

"Person". Section 1—201.

"Purchaser". Section 1—201.

"Secured party". Section 9—105.

"Security interest". Section 1—201.

"Value". Section 1—201.

"Writing". Section 1—201.

#### NORTH CAROLINA COMMENT

This section is very similar in approach to GS 25-9-313, which relates to fixtures. Subsection (1) gives priority to security interests which attach before the goods are installed. Prior North Carolina law was in accord at least as to goods which did not become an integral part of the chattel to which they were attached. *Goodrich*

*Silvertown Stores v. Bennett Motor Co.*, 214 N.C. 85, 197 S.E. 698 (1938) (security interest in tires has priority over the security interest in the automobile). However, the Official Comments to GS 25-9-314 indicate that this section is intended to achieve a result opposite to that of *Twin City Motor Co. v. Rouzer Motor Co.*, 197

N.C. 371, 148 S.E. 461 (1929), wherein a security interest in an automobile was held superior to a subsequent chattel mortgage on a motor placed in the automobile.

No cases have been found dealing with the other problems in this section, but see North Carolina Comment to GS 25-9-313 for analogous cases involving fixtures.

**§ 25-9-315. Priority when goods are commingled or processed.—**

(1) If a security interest in goods was perfected and subsequently the goods or a part thereof have become part of a product or mass, the security interest continues in the product or mass if

(a) the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass; or

(b) a financing statement covering the original goods also covers the product into which the goods have been manufactured, processed or assembled.

In a case to which paragraph (b) applies, no separate security interest in that part of the original goods which has been manufactured, processed or assembled into the product may be claimed under § 25-9-314.

(2) When under subsection (1) more than one security interest attaches to the product or mass, they rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

1. To state when a secured party whose collateral contributes to a product has priority over others who have conflicting claims in the same product.

2. This section changes the law in some jurisdictions where a security interest in goods (e. g., raw materials) was lost when the goods lost their identity by being commingled or processed. Under this section the security interest continues in the resulting mass or product in the cases stated in subsection (1).

3. This section applies not only to cases where flour, sugar and eggs are commingled into cake mix or cake, but also to cases where components are assembled into a machine. In the latter case a secured

party is put to an election at the time of filing, by the last sentence of subsection (1), whether to claim under this section or to claim a security interest in one component under Section 9—314.

4. Subsection (2) is new and is needed because under subsection (1) it is possible to have more than one secured party claiming an interest in a product. The rule stated treats all such interests as being of equal priority entitled to share ratably in the product.

**Cross references:**

Sections 9—204(1), 9—303, 9—312(1) and 9—314.

**Definitional cross references:**

"Goods". Section 9—105.

"Security interest". Section 1—201.

**NORTH CAROLINA COMMENT**

This section is essentially new. It is intended to replace some decisions which held that a mortgage on goods was lost if the goods lost their identity by being processed. See Official Comment 2. No North Carolina chattel mortgage cases have been

found. The North Carolina Factor's Lien Act, GS 44-71, did permit a general lien upon goods in process which by implication extended to the goods after their original identity was lost.

**§ 25-9-316. Priority subject to subordination.—**Nothing in this article prevents subordination by agreement by any person entitled to priority. (1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** None.

**Purposes:**

The several preceding sections deal elaborately with questions of priority. This section is inserted to make it entirely clear that a person entitled to priority may effectively agree to subordinate his claim. Only the person entitled to priority

may make such an agreement: his rights cannot be adversely affected by an agreement to which he is not a party.

**Cross references:**

Sections 1—102 and 9—312(1).

**Definitional cross references:**

"Agreement". Section 1—201.

"Person". Section 1—201.



## NORTH CAROLINA COMMENT

This section to the effect that a holder of a prior interest may by agreement subordinate his security interest to a security interest with a lower priority, is in accord

with prior North Carolina law. See *Avery County Bank v. Smith*, 186 N.C. 635, 120 S.E. 215 (1923).

**§ 25-9-317. Secured party not obligated on contract of debtor.**—The mere existence of a security interest or authority given to the debtor to dispose of or use collateral does not impose contract or tort liability upon the secured party for the debtor's acts or omissions. (1961, c. 574; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 12, Uniform Trust Receipts Act.

**Changes:** Rewritten; no changes in substance.

**Purposes of changes:**

There were a few common law decisions, mostly in cases involving trust receipts, which suggested, if they did not hold, that a secured party who gave his debtor liberty of sale might be liable (for example, for breach of warranty) on the debtor's contracts of sale. The theory was grounded on the law of agency; the debtor being regarded as selling agent for the secured party as principal. This section rejects that theory. Section 12 of the Uni-

form Trust Receipts Act provided that the entruster was not subject to liability, merely because of his status as entruster, on sale of the goods subject to trust receipt. This section adopts the policy of the prior act and states it in general terms.

**Cross reference:**

Section 2—210(4).

**Definitional cross references:**

"Collateral". Section 9—105.

"Contract". Section 1—201.

"Debtor". Section 9—105.

"Secured party". Section 9—105.

"Security interest". Section 1—201.

## NORTH CAROLINA COMMENT

This section is in accord with the North Carolina Uniform Trust Receipts Act, GS

45-57. No cases from North Carolina have been found.

**§ 25-9-318. Defenses against assignee; modification of contract after notification of assignment; term prohibiting assignment ineffective; identification and proof of assignment.**—(1) Unless an account debtor has made an enforceable agreement not to assert defenses or claims arising out of a sale as provided in § 25-9-206 the rights of an assignee are subject to

(a) all the terms of the contract between the account debtor and assignor and any defense or claim arising therefrom; and

(b) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment.

(2) So far as the right to payment under an assigned contract right has not already become an account, and notwithstanding notification of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards is effective against an assignee unless the account debtor has otherwise agreed but the assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor.

(3) The account debtor is authorized to pay the assignor until the account debtor receives notification that the account has been assigned and that payment is to be made to the assignee. A notification which does not reasonably identify the rights assigned is ineffective. If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made and unless he does so the account debtor may pay the assignor.

(4) A term in any contract between an account debtor and an assignor which prohibits assignment of an account or contract right to which they are parties is ineffective. (1945, c. 196, s. 6; 1961, c. 574; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 9(3), Uniform Trust Receipts Act.

**Purposes:**

1. Subsection (1) makes no substantial change in prior law. An assignee has traditionally been subject to defenses or set-offs existing before an account debtor is notified of the assignment. When the account debtor's defenses on an assigned account, chattel paper or a contract right arise from the contract between him and the assignor it makes no difference whether the breach giving rise to the defense occurs before or after the account debtor is notified of the assignment (subsection (1) (a)). The account debtor may also have claims against the assignor which arise independently of that contract: an assignee is subject to all such claims which accrue before, and free of all those which accrue after, the account debtor is notified (subsection (1) (b)). The account debtor may waive his right to assert claims or defenses against an assignee to the extent provided in Section 9—206.

2. "Contract rights" as defined in Section 9—106 are in general rights to payments of money to be earned under an existing contract. Prior law was in confusion as to whether modification of an executory contract by account debtor and assignor without the assignee's consent was possible after notification of an assignment. Subsection (2) makes good faith modifications by assignor and account debtor without the assignee's consent effective against the assignee even after notification. This rule may do some violence to accepted doctrines of contract law. Nevertheless it is a sound and indeed a necessary rule in view of the realities of large scale procurement. When for example it becomes necessary for a government agency to cut back or modify existing contracts, comparable arrangements must be made promptly in hundreds and even thousands of subcontracts lying in many tiers below the prime contract. Typically the right to payments under these subcontracts will have been assigned. The government, as sovereign, might have the right to amend or terminate existing contracts apart from statute. This subsection gives the prime contractor (the account debtor) the right to make the required arrangements directly with his subcontractors without undertaking the task of procuring assents from the many banks to whom rights under the contracts may have been assigned. Assignees are protected by the provision which gives

them automatically corresponding rights under the modified or substituted contract. Notice that subsection (2) applies only "so far as the right to payment under an assigned contract right has not already become an account," and therefore its application ends entirely when the work is done or the goods furnished.

3. Subsection (3) clarifies the right of an account debtor to make payment to his seller-assignor in an "indirect collection" situation (see Comment to Section 9—308). So long as the assignee permits the assignor to collect accounts or leaves him in possession of chattel paper which does not indicate that payment is to be made at some place other than the assignor's place of business, the account debtor may pay the assignor even though he may know of the assignment. In such a situation an assignee who wants to take over collections must notify the account debtor to make further payments to him.

4. Subsection (4) breaks sharply with the older contract doctrines by denying effectiveness to contractual terms prohibiting assignment of accounts and contract rights—that is, sums due and to become due under contracts of sale, construction contracts and the like. Under the rule as stated an assignment would be effective even if made to an assignee who took with full knowledge that the account debtor had sought to prohibit or restrict assignment of the account or of the money to be earned under the contract.

It is only for the past hundred years that our law has recognized the possibility of assigning choses in action. The history of this development, at law and equity, is in broad outline well known. Lingering traces of the absolute common law prohibition have survived almost to our own day.

There can be no doubt that a term prohibiting assignment of proceeds was effective against an assignee with notice through the nineteenth century and well into the twentieth. Section 151 of the Restatement of Contracts (1932) so states the law without qualification.

That rule of law has been progressively undermined by a process of erosion which began much earlier than the cited section of the Restatement of Contracts would suggest. The cases are legion in which courts have construed the heart out of prohibitory or restrictive terms and held the assignment good. The cases are not lacking where courts have flatly held assignments valid without bothering to construe away the prohibition. See 4 Corbin

on Contracts (1951) §§ 872, 873. Such cases as *Allhusen v. Caristo Const. Corp.*, 303 N.Y. 446, 103 N.E.2d 891 (1952), would be rejected by this subsection.

This gradual and largely unacknowledged shift in legal doctrine has taken place in response to economic need: as accounts and contract rights have become the collateral which secures an ever increasing number of financing transactions, it has been necessary to reshape the law so that these intangibles, like negotiable instruments and negotiable documents of title, can be freely assigned.

Subsection (4) thus states a rule of law which is widely recognized in the cases and which corresponds to current business practices. It can be regarded as a revolutionary departure only by those who still cherish the hope that we may yet return to the views entertained some two hundred years ago by the Court of King's Bench.

5. The Federal Assignment of Claims Act of 1940—to which of course this section is subject—requires that assignments of claims against the United States be filed as provided in that Act. Many large business enterprises, situated like the United States in that claims against them are held by hundreds or thousands of subcontractors or suppliers, often require in their contract or purchase order forms that assignments against them be filed in a prescribed way. Subsection (3) requires reasonable identification of the account or contract right assigned and recognizes the right of an account debtor to require reasonable proof of the making of the as-

signment and to that extent validates such requirements in contracts or purchase order forms. If the notification does not contain such reasonable identification or if such reasonable proof is not furnished on request the account debtor may disregard the assignment and make payment to the assignor. What is "reasonable" is not left to the arbitrary decision of the account debtor; if there is doubt as to the adequacy either of a notification or of proof submitted after request, the account debtor may not be safe in disregarding it unless he has notified the assignee with commercial promptness as to the respects in which identification or proof is considered defective.

6. If the thing to be assigned is the beneficiary's right under a letter of credit, Section 5—116 should be consulted.

#### Cross references:

Point 1: Section 9—206.

Point 3: Sections 9—205 and 9—308.

Point 4: Section 2—210(2) and (3).

Point 6: Section 5—116.

#### Definitional cross references:

"Account". Section 9—106.

"Account debtor". Section 9—105.

"Agreement". Section 1—201.

"Contract". Section 1—201.

"Contract right". Section 9—106.

"Good faith". Section 1—201.

"Party". Section 1—201.

"Receives", notification. Section 1—201.

"Rights". Section 1—201.

"Sale". Sections 2—106 and 9—105.

"Seasonably". Section 1—204.

"Term". Section 1—201.

### NORTH CAROLINA COMMENT

*Subsection (1)* is in accord with prior North Carolina law. In *William Iselin & Co. v. Saunders*, 231 N.C. 642, 58 S.E.2d 614 (1950), the court stated: "The assignee of a nonnegotiable chose in action, though he buys it for value, in good faith, and before maturity, takes subject to all defenses which the debtor may have had against the assignor based on facts existing at the time of the assignment or on facts arising thereafter but prior to the debtor's knowledge of the assignment." Accord: *Jennings & Sons v. Howard*, 212 N.C. 490, 193 S.E. 819 (1937). See also North Carolina Comment to GS 25-9-206.

*Subsection (2)* probably changes North Carolina law. No cases have been found, but heretofore, most courts would hold ineffective any change in the basic executory contract made by the account debtor and the assignor after assignment.

*Subsection (3)* makes a slight change in prior law. The former rules provided that

the account debtor was free to pay the assignor only until such time as he received notice of the assignment, irrespective of the source of the notice. *Lipe Motor Lines v. Guilford Nat'l Bank*, 236 N.C. 323, 72 S.E.2d 759 (1952) (dictum); *Ellis v. Amason*, 17 N.C. 273 (1832). GS 44-82 was generally in accord. The Code puts the burden on the assignee to notify the account debtor and to specify to whom payment is to be made. Absent specification, the account debtor is entitled to pay the assignor.

*Subsection (4)* provides that a contractual restriction on transfer of an account shall be ineffective. No North Carolina cases have been found. However, during the last few years the courts have become increasingly adverse to the clause restricting assignment and are probably moving in the direction of subsection (4). See Official Comment 4.



## PART 4.

## FILING.

**§ 25-9-401. Place of filing; erroneous filing; removal of collateral.**

—(1) The proper place to file in order to perfect a security interest is as follows:

(a) when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the register of deeds in the county of the debtor's residence or if the debtor is not a resident of this State then in the office of the register of deeds in the county where the goods are kept, and in addition when the collateral is crops in the office of the register of deeds in the county where the land on which the crops are growing or to be grown is located;

(b) when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;

(c) in all other cases, in the office of the Secretary of State and in addition, if the debtor has a place of business in only one county of this State, also in the office of the register of deeds of such county, or, if the debtor has no place of business in this State, but resides in the State, also in the office of the register of deeds of the county in which he resides.

(2) A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this State continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

(4) If collateral is brought into this State from another jurisdiction, the rules stated in § 25-9-103 determine whether filing is necessary in this State. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C. S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 3; c. 196, s. 2; 1955, c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1.)

**Editor's Note.**—Subsection (1) is the "Third Alternative" discussed in the Official and North Carolina Comments on this section. Subsection (3) is principal

subsection (3) of 1962 Official Text and not the alternative discussed in Official Comment 6 and the North Carolina Comment.

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 4, Uniform Trust Receipts Act; Sections 6 and 7, Uniform Conditional Sales Act.

**Purposes:**

1. Under chattel mortgage acts, the Uniform Conditional Sales Act and other conditional sales legislation the geographical unit for filing or recording was local: the county or township in which the mortgagor or vendee resided or in which the goods sold or mortgaged were kept. The Uniform Trust Receipts Act used the state as the geographical filing unit: under that Act statements of trust receipt financing were filed with an official in the state capital and were not filed locally. The state-wide filing system of the Trust Receipts Act has been followed

in many accounts receivable and factor's lien acts.

Both systems have their advocates and both their own advantages and drawbacks. The principal advantage of state-wide filing is ease of access to the credit information which the files exist to provide. Consider for example the national distributor who wishes to have current information about the credit standing of the thousands of persons he sells to on credit. The more completely the files are centralized on a state-wide basis, the easier and cheaper it becomes to procure credit information; the more the files are scattered in local filing units, the more burdensome and costly. On the other hand, it can be said that most credit inquiries about local businesses, farmers and

consumers come from local sources; convenience is served by having the files locally available and there is no great advantage in centralized filing.

This section does not attempt to resolve the controversy between the advocates of a completely centralized state-wide filing system and those of a large degree of local autonomy. Instead the section is drafted in a series of alternatives; local considerations of policy will determine the choice to be made.

2. Fortunately there is general agreement that the proper filing place for security interests in fixtures is in the office where a mortgage on the real estate concerned would be filed or recorded, and subsection (1) (a) in the First Alternative and subsection (1) (b) in the Second and Third Alternatives so provide. This provision follows the Uniform Conditional Sales Act. Note that there is no requirement for an additional filing with the chattel records.

3. In states where it is felt wise to preserve local filing for transactions of essentially local interest, either the Second or Third Alternatives of subsection (1) should be adopted. Subsection (1) (a) in both alternatives provides county (township, etc.) filing for consumer goods transactions and for agricultural transactions (farm equipment, farm products, farm accounts and crops). Note that the subsection departs from Section 6 of the Uniform Conditional Sales Act and adopts instead the policy of many chattel mortgage acts in selecting the county of the debtor's residence, rather than the county where the goods are located, as the normal filing place. Where, however, the debtor is an out-of-state resident the filing must of necessity be in the county where the goods are, and the subsection so provides. Though not expressly stated, it is evident that filing for an assignment of accounts arising from the sale of farm products by a farmer who is not a resident must be in the county where the debtor keeps his farm products. In the case of crops, where the land is in one county and the debtor's residence in another, filing must be made in both counties. The policy of the subsection is to require filing in the place or places where a creditor would normally look for information concerning interests created by the debtor.

4. It is thought that sound policy requires a state-wide filing system for all transactions except the essentially local ones covered in subsection (1) (a) of the Second and Third Alternatives and transactions involving fixtures covered in sub-

section (1) (b) of the Second and Third Alternatives. Subsection (1) (c) so provides in both alternatives, as does subsection (1) (b) in the First Alternative. In a state which has adopted either the Second or Third Alternative, central filing would be required when the collateral was any kind of goods except consumer goods, farm equipment or farm products (including crops); documents; chattel paper; and accounts, contract rights and general intangibles, unless related to a farm. Note that the filing provisions of this Article, do not apply to instruments (see Section 9—304).

If the Third Alternative subsection (1) is adopted, then local filing, in addition to the central filing, is required in all the cases stated in the preceding paragraph, with respect to any debtor whose places of business within the state are all within a single county (township, etc.) or a debtor who is not engaged in business.

In states where the arguments for a completely centralized set of files (except for fixtures) prevail, the First Alternative subsection (1) should be adopted. That alternative provides for exclusive central filing of all security interests except those in fixtures.

5. When a secured party has in good faith attempted to comply with the filing requirements but has not done so correctly, subsection (2) makes his filing effective in so far as it was proper, and also makes it good for all collateral covered by the financing statement against any person who actually knows the contents of the improperly filed statement. The subsection rejects the occasional decisions that an improperly filed record is ineffective to give notice even to a person who knows of it. But if the Third Alternative subsection (1) is adopted, the requirements of subsection (1) (c) are not complied with unless there is filing in both offices specified; filing in only one of two required places is not effective except as against one with actual knowledge.

6. Subsection (3) deals with change of residence or place of business or the location or use of the goods after a proper filing has been made. The subsection is important only when local filing is required, and covers only changes between local filing units in the state. For changes of location between states see Section 9—103(3).

Subsection (3) is presented in alternative forms. Under the first no new filing is required in the county to which the collateral has been removed. Under alter-

native subsection (3) the original filing lapses four months after the change in location; this is the same rule that is applied by Section 9—103(3) to the case of collateral brought into the state subject to a security interest which attached elsewhere.

**Cross references:**

Sections 9—302, 9—304 and 9—307(2).

Point 2: Section 9—313.

Point 6: Section 9—103(3).

**Definitional cross references:**

"Account". Section 9—106.

"Collateral". Section 9—105.

"Consumer goods". Section 9—109.

"Debtor". Section 9—105.

"Equipment". Section 9—109.

"Farm products". Section 9—109.

"Financing statement". Section 9—402.

"Good faith". Section 1—201.

"Goods". Section 9—105.

"Knowledge". Section 1—201.

"Person". Section 1—201.

"Secured party". Section 9—105.

"Security interest". Section 1—201.

"Signed". Section 1—201.

### NORTH CAROLINA COMMENT

North Carolina statutes did not provide for the filing or registration of security interests in the office of the Secretary of State; that is, the State had no "central filing" of security interests. In view of this fact, the most desirable alternative for co-ordination with existing practice is the Third Alternative to subsection (1). This alternative permits the maximum amount of local filing, while retaining central filing for those situations in which it is deemed to be most advantageous. Detailed comparisons of subsection (1) with the prior registration system would of necessity be extensive and probably futile. Suffice it to say that prior law and the Code are in agreement that where there are a number of possible places to file, the most logical is generally the location of the residence of the debtor, or if the debtor has no residence in the State, the location of the goods. However, the device of local filing under the Code is limited to four situations: (1) When collateral is equipment used in farming operations, or farm products, or accounts, etc., arising from sale of farm products; (2) when collateral is consumer goods; (3) when collateral is intended to become a fixture; and (4) when debtor has a place of business in only one county or city of the State, or has no place of business but does have a residence in the State, in which case both local and central filings must be made. In all other situations only central filing need be made.

Subsection (b) relating to the filing of security interests in goods which are to become fixtures probably changes North Carolina law. There was no North Carolina statute on the subject, but the place of filing under prior law probably would have been the place of filing of personal property. *Standard Motors Fin. Co. v. Weaver*, 199 N.C. 178, 153 S.E. 861 (1930) (subjecting chattel to encumbrance indicates intention that it remain personalty).

Subsection (2) affords a limited validity to filings which are made in the wrong place. This would change prior law. "The recordation of a chattel mortgage or a conditional sale in any county other than that specified by law is of no effect." *Montague Bros. v. W. C. Shepherd Co.*, 231 N.C. 551, 58 S.E.2d 118 (1950) (dictum). See also *Bank of Colerain v. Cox*, 171 N.C. 76, 87 S.E. 967 (1916).

There is one alternative to subsection (3). However, the principal subsection, which provides that a filing which is initially made in the proper place remains effective even though the determinative facts have subsequently changed, is in accord with prior law. *Montague Bros. v. W. C. Shepherd Co.*, 231 N.C. 551, 58 S.E.2d 118 (1950); *Harris v. Allen*, 104 N.C. 86, 10 S.E. 127 (1889).

Subsection (4) reaffirms that the rules of GS 25-9-103 govern when security is brought in from another state. See North Carolina Comment to GS 25-9-103.

### § 25-9-402. Formal requisites of financing statement; amendments.

—(1) A financing statement is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. When the financing statement covers crops growing or to be grown or goods which are or are to become fixtures, the statement must also contain a description of the real estate concerned and the name of the record owner or record lessee thereof. A copy of the security agreement is



sufficient as a financing statement if it contains the above information and is signed by both parties.

(2) A financing statement which otherwise complies with subsection (1) is sufficient although it is signed only by the secured party when it is filed to perfect a security interest in

(a) collateral already subject to a security interest in another jurisdiction when it is brought into this State. Such a financing statement must state that the collateral was brought into this State under such circumstances.

(b) proceeds under § 25-9-306 if the security interest in the original collateral was perfected. Such a financing statement must describe the original collateral.

(3) A form substantially as follows is sufficient to comply with subsection (1):

Name of debtor (or assignor) .....  
Address .....  
Name of secured party (or assignee) .....  
Address .....

1. This financing statement covers the following types (or items) of property:

(Describe) .....

2. (If collateral is crops) The above described crops are growing or are to be grown on:

(Describe Real Estate Including Record Owner or Record Lessee of Same) .....

3. (If collateral is goods which are or are to become fixtures) The above described goods are affixed or to be affixed to:

(Describe Real Estate Including Record Owner or Record or Record Lessee of Same) .....

4. (If proceeds or products of collateral are claimed) Proceeds—Products of the collateral are also covered.

Signature of Debtor (or Assignor) .....

Signature of Secured Party (or Assignee) .....

(4) The term “financing statement” as used in this article means the original financing statement and any amendments but if any amendment adds collateral, it is effective as to the added collateral only from the filing date of the amendment.

(5) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading. (1899, cc. 17, 247; 1901, cc. 329, 704; 1903, c. 489; 1905, cc. 226, 319; Rev., s. 2055; 1907, c. 843; 1909, c. 532; P. L. 1913, c. 49; C. S., s. 2490; 1925, c. 285, s. 1; 1931, c. 196; 1933, c. 101, s. 6; 1945, c. 182, s. 2; c. 196, s. 2; 1951, c. 926, s. 1; 1955, c. 386, s. 1; 1957, c. 564; 1961, c. 574; 1965, c. 700, s. 1.)

OFFICIAL COMMENT

**Prior uniform statutory provision:** Sections 13(3), 13(4), Uniform Trust Receipts Act.

**Purposes:**

1. Subsection (1) sets out the simple formal requisites of a financing statement under this Article. These requirements are: (1) signatures and addresses of both parties; (2) a description of the collateral by type or item. Where the collateral is growing crops or fixtures, the financing statement must also contain a description of the land concerned. Section 9—110 provides that “any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identi-

fies what is described”. Subsection (3) suggests a form which complies with the statutory requirements. A copy of the security agreement may be filed in place of a separate financing statement, if it is signed by both parties and contains the required information.

2. This section adopts the system of “notice filing” which has proved successful under the Uniform Trust Receipts Act. What is required to be filed is not, as under chattel mortgage and conditional sales acts, the security agreement itself, but only a simple notice which may be filed before the security interest attaches or thereafter. The notice itself indicates

merely that the secured party who has filed may have a security interest in the collateral described. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs. Section 9—208 provides a statutory procedure under which the secured party, at the debtor's request, may be required to make disclosure. Notice filing has proved to be of great use in financing transactions involving inventory, accounts and chattel paper, since it obviates the necessity of refileing on each of a series of transactions in a continuing arrangement where the collateral changes from day to day. Where other types of collateral are involved, the alternative procedure of filing a signed copy of the security agreement may prove to be the simplest solution.

3. This section departs from the requirements of many chattel mortgage statutes that the instrument filed be acknowledged or witnessed or accompanied by affidavits of good faith. Those requirements do not seem to have been successful as a deterrent to fraud; their principal effect has been to penalize good faith mortgagees who have inadvertently failed to comply with the statutory niceties. They are here abandoned in the interest of a simplified and workable filing system.

4. Subsection (2) allows the secured party to file a financing statement signed only by himself where the filing is with reference to collateral already subject to a security interest in another jurisdiction when brought into this state or with reference to proceeds when his security interest in the original collateral was perfected. (Section 9—103 states when a financing statement must be filed when collateral is brought into this state; Section 9—306 defines proceeds and states when refileing is necessary to continue a perfected security interest in them.) Section 9—401(3), alternative provision, contains similar permission on removal between counties in this state. The reason

for dispensing with the debtor's signature in the two cases covered by subsection (2) and in the case covered by Section 9—401(3), is that the necessity for refileing arises from actions of the debtor (in moving his place of business or residence, or the collateral, or disposing of it), which may have been unauthorized or fraudulent. The secured party should not be penalized for failure to make a timely filing by reason of difficulty in procuring the signature of a possibly reluctant or hostile debtor. Financing statements filed under this subsection must explain the circumstances under which they are filed (e. g., that the collateral was brought here from another state where a security interest attached, or has been moved from one county to another in this state, or, in the case of proceeds, describing the original collateral).

5. Subsection (5) is in line with the policy of this Article to simplify formal requisites and filing requirements and is designed to discourage the fanatical and impossibly refined reading of such statutory requirements in which courts have occasionally indulged themselves. As an example of the sort of reasoning which this subsection rejects, see *General Motors Acceptance Corporation v. Haley*, 329 Mass. 559, 109 N.E.2d 143 (1952).

#### Cross references:

Point 1: Section 9—110.

Point 2: Section 9—208.

Point 4: Sections 9—103, 9—306 and 9—401(3).

#### Definitional cross references:

"Collateral". Section 9—105.

"Debtor". Section 9—105.

"Goods". Section 9—105.

"Party". Section 1—201.

"Proceeds". Section 9—306.

"Secured party". Section 9—105.

"Security agreement". Section 9—105.

"Security interest". Section 1—201.

"Signed". Section 1—201.

### NORTH CAROLINA COMMENT

This section adopts a "notice filing" system similar to that formerly in use in North Carolina as to trust receipts, factor's liens, and notice of assignment of accounts receivable. Under such a system, the security agreement proper need not be registered; a financing statement containing such general information as is deemed sufficient to put a party searching the record on notice that there is a security agreement outstanding against a particular person covering certain types of collateral is

all that need be filed. It should be noted that a financing statement is not required; the parties can, if they choose, file the security agreement instead.

Prior law required that the entire written agreement which resulted in a chattel mortgage, conditional sale, or crop lien be registered. The Code changes the requirement.

With the exception of the Uniform Trust Receipts Act, prior law required that the instrument recorded be formally acknowl-

edged. A formal defect in the acknowledgment of the debtor rendered the registration totally void. *Todd v. Outlaw*, 79 N.C. 235 (1878). The Code does not require that the instrument be acknowledged nor is the

filing defeated if the requirements are substantially complied with.

GS 25-9-110 sets out the standards for sufficient description of the property.

**§ 25-9-403. What constitutes filing; duration of filing; effect of lapsed filing; duties of filing officer.**—(1) Presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer constitutes filing under this article.

(2) A filed financing statement which states a maturity date of the obligation secured of five years or less is effective until such maturity date and thereafter for a period of sixty days. Any other filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of such sixty-day period after a stated maturity date or on the expiration of such five-year period, as the case may be, unless a continuation statement is filed prior to the lapse. Upon such lapse the security interest becomes unperfected. A filed financing statement which states that the obligation secured is payable on demand is effective for five years from the date of filing.

(3) A continuation statement may be filed by the secured party (i) within six months before and sixty days after a stated maturity date of five years or less, and (ii) otherwise within six months prior to the expiration of the five-year period specified in subsection (2). Any such continuation statement must be signed by the secured party, identify the original statement by file number and state that the original statement is still effective. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years after the last date to which the filing was effective whereupon it lapses in the same manner as provided in subsection (2) unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement. Unless a statute on disposition of public records provides otherwise, the filing officer may remove a lapsed statement from the files and destroy it.

(4) A filing officer shall mark each statement with a consecutive file number and with the date and hour of filing and shall hold the statement for public inspection. In addition the filing officer shall index the statements according to the name of the debtor and shall note in the index the file number and the address of the debtor given in the statement. If the instrument covers goods which are, or are to become fixtures, he shall file or record the same in accordance with the requirements which he is required to observe with respect to the filing or recording of mortgages of real estate under the laws of this State.

(5) The uniform fee for filing, indexing and furnishing filing data for an original or a continuation statement shall be two dollars (\$2.00) for an approved statutory form statement as prescribed in § 25-9-402 when printed on a standard size form approved by the Secretary of State, and for all other statements, a three dollar (\$3.00) minimum charge for up to and including three pages and one dollar (\$1.00) per page for all over three pages. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C. S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, ss. 2, 4; c. 196, s. 2; 1955, c. 386, ss. 1, 2; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 13(3), 13(4), Uniform Trust Receipts Act; Section 10, Uniform Conditional Sales Act.

**Changes:** Changed in substance.

**Purposes of changes:**

1. Prior law was not always clear

whether a mortgage filed for record gave constructive notice from the time of presentation to the filing officer or only from the time of indexing. Subsection (1) adopts the former position.

2. Prior statutes have usually limited the effectiveness of a filing to a specified



period of time after which refileing is necessary. Subsection (2) follows the same policy, establishing a maximum length of five years as the filing period. If the financing statement states a maturity date of five years or less, there is added a sixty-day grace period within which the original filing may be continued without lapse. A financing statement which states that the obligation secured is payable on demand is treated as one which does not state a maturity date. The five year maximum period is substantially longer than that accorded under most prior statutes. Subsection (3) provides for the filing of one or more continuation statements (which need be signed only by the secured party) if it is desired to continue the effectiveness of the original filing.

3. Under the fourth sentence of subsection (2) the security interest becomes unperfected when filing lapses. Thereafter, the interest of the secured party is subject to defeat by those persons who take priority over an unperfected security interest (see Section 9-301), and under Section 9-312(5) the holder of a perfected conflicting security interest is such a person even though before lapse the conflicting interest was junior. Compare the situation

arising under Section 9-103(3) when a perfected security interest under the law of another jurisdiction is not perfected in this state within four months after the property is brought into this state.

Thus if A and B both make non-purchase money advances against the same collateral, and both perfect security interests by filing, A who files first is entitled to priority under Section 9-312(5) (a). But if no continuation statement is filed, A's filing may lapse first. So long as B's interest remains perfected thereafter, he is entitled to priority over A's unperfected interest. This rule avoids the circular priority which arose under some prior statutes, under which A was subordinate to the debtor's trustee in bankruptcy, A retained priority over B, and B's interest was valid against the trustee in bankruptcy. In re Andrews, 172 F.2d 996 (7th Cir. 1949).

#### Cross references:

Point 3: Sections 9-103(3), 9-301 and 9-312(5).

#### Definitional cross references:

"Debtor". Section 9-105.

"Financing statement". Section 9-402.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

### NORTH CAROLINA COMMENT

*Subsection (1)* is in accord with the North Carolina Uniform Trust Receipts Act, GS 45-58 (c). The subsection was intended to make clear that the security interest serves as constructive notice from the time of filing, i.e., presentation of instrument and payment of the fee. This implicitly removes the burden of failure to index from the secured party. This changes North Carolina law as to security interests other than trust receipts. Under prior law a registration did not serve as constructive notice until it had been properly indexed and cross-indexed. Johnson Cotton Co. v. Hobgood, 243 N.C. 227, 90 S.E.2d 541 (1955) (dictum); Ely v. Norman, 175 N.C. 294, 95 S.E. 543 (1918). Thus, the failure of the register to perform his duties properly was the responsibility of the secured party under prior law.

*Subsection (2)* provides that a financing statement without a maturity date will remain effective for five years. Prior law varied from one year for trust receipts, GS 45-58 (d), to fifteen years following the maturity date for mortgages, GS 45-37.

*Subsection (3)* sets out the requirements for filing of continuation statements. Prior law had such provisions which varied with the type of security interest. See GS 45-58 (e) (trust receipts), 45-37 (5) (mortgages), 44-78 (4) (assignments of accounts).

*Subsection (4)* requires that the filing officer mark each statement with the date and hour of filing. This was required by prior law. GS 161-14 (registration of instruments). The subsection requires that only one index, in the name of the debtor, be maintained. This changes the previous practice of maintaining two indexes, one in the name of the debtor and another in the name of the secured party. GS 161-14. In addition, the Code requires that the address of the debtor be noted in the index. Apparently, this was not done under prior law.

The prior system of filing fees set the basic price for recording a statutory form of chattel mortgage at \$.25. GS 161-10. However, there were numerous local exceptions with fees ranging to \$1.00 for the chattel mortgage. GS 161-10.1.

**§ 25-9-404. Termination statement.**—(1) Whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value, the secured party must on written demand by the debtor send the debtor a statement that he no longer claims a security interest un-

der the financing statement, which shall be identified by file number. A termination statement signed by a person other than the secured party of record must include or be accompanied by the assignment or a statement by the secured party of record that he has assigned the security interest to the signer of the termination statement. The uniform fee for filing and indexing such an assignment or statement thereof shall be two dollars (\$2.00). If the affected secured party fails to send such a termination statement within ten days after proper demand therefor he shall be liable to the debtor for one hundred dollars (\$100.00), and in addition for any loss caused to the debtor by such failure.

(2) On presentation to the filing officer of such a termination statement he must note it in the index. The termination statement shall then remain in the file for such period of time as the financing statement or a continuation statement would be effective under the five year life provided in § 25-9-403, and then may be destroyed. The filing officer shall remove from the files, mark "terminated" and send or deliver to the secured party the financing statement and any continuation statement, statement of assignment or statement of release pertaining thereto.

(3) The uniform fee for filing and indexing a termination statement including sending or delivering the financing statement shall be one dollar (\$1.00).

(4) Termination of a financing statement or security agreement may be made by presenting the original financing statement or an executed duplicate original thereof or the security agreement or an executed duplicate original thereof marked paid and satisfied and signed by an authorized representative of the secured party or assignee thereof, including any person clothed with apparent authority to sign. The fact that a person has such paper in his possession may be deemed prima-facie evidence of such authority. Upon receipt of such original marked paid and satisfied, the register of deeds shall stamp the same cancelled and make the entry in the indexes for such paper showing that it has been terminated, cancelled and satisfied, and retain of record the filed or recorded statement or agreement so marked paid and satisfied. (1945, c. 182, s. 5; c. 196, s. 3; 1961, c. 574; 1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 12, Uniform Conditional Sales Act.

**Changes:** Modified to conform to the scheme of this Article.

##### Purposes of changes:

1. To provide a procedure for noting discharge of the secured obligation on the records and for noting that a financing arrangement has been terminated.

2. This section makes only formal changes, if any, in discharge procedures under prior law. It adds to the usual provisions one covering the problem which arises because a secured party under a notice filing system may file notice of an intention to make advances which may

never be made. Under this section a debtor may require a secured party to send a termination statement when there is no outstanding obligation and no commitment to make future advances.

##### Cross reference:

Point 2: Section 9—402(1).

##### Definitional cross references:

"Debtor". Section 9—105.

"Financing statement". Section 9—402.

"Person". Section 1—201.

"Secured party". Section 9—105.

"Security interest". Section 1—201.

"Send". Section 1—201.

"Value". Section 1—201.

"Written". Section 1—201.

#### NORTH CAROLINA COMMENT

This section provides for a uniform method of terminating a financing statement or cancelling a security interest. It

replaces GS 44-74, 44-79, 45-37 through 45-42.1, 45-58 (g).

**§ 25-9-405. Assignment of security interest; duties of filing officer; fees.**—(1) A financing statement may disclose an assignment of a security interest in the collateral described in the statement by indication in the statement of the name and address of the assignee or by an assignment itself or a copy thereof on the face or back of the statement. Either the original secured party or the assignee may sign this statement as the secured party. On presentation to

the filing officer of such a financing statement the filing officer shall mark the same as provided in § 25-9-403 (4). The uniform fee for filing, indexing and furnishing filing data for a financing statement so indicating an assignment shall be a minimum charge of three dollars (\$3.00) for the first three pages and one dollar (\$1.00) for each additional page.

(2) A secured party may assign of record all or a part of his rights under a financing statement by the filing of a separate written statement of assignment signed by the secured party of record and setting forth the name of the secured party of record and the debtor, the file number and the date of filing of the financing statement and the name and address of the assignee and containing a description of the collateral assigned. A copy of the assignment is sufficient as a separate statement if it complies with the preceding sentence. On presentation to the filing officer of such a separate statement, the filing officer shall mark such separate statement with the date and hour of the filing. He shall note the assignment on the index of the financing statement. The uniform fee for filing, indexing and furnishing filing data about such a separate statement of assignment shall be a minimum charge of two dollars (\$2.00) up to and including the first two pages and one dollar (\$1.00) per page for all over three pages.

(3) After the disclosure or filing of an assignment under this section, the assignee is the secured party of record. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

This section provides a permissive device whereby a secured party who has assigned all or part of his interest may have the assignment noted of record. Note that under Section 9—302(2) no filing of such an assignment is required as a condition of continuing the perfected status of the security interest against creditors and transferees of the original debtor. A secured party who has assigned his interest might wish to have the fact noted of record, so that inquiries concerning the transaction would be addressed not to him but to the assignee (see Point 2 of Comment to Section 9—402). After a secured party has assigned his rights of record,

the assignee becomes the “secured party of record” and may file a continuation statement under Section 9—403, a termination statement under Section 9—404, or a statement of release under Section 9—406.

**Cross references:**

Sections 9—302(2) and 9—402 through 9—406.

**Definitional cross references:**

“Collateral”. Section 9—105.

“Debtor”. Section 9—105.

“Financing statement”. Section 9—402.

“Rights”. Section 1—201.

“Secured party”. Section 9—105.

“Signed”. Section 1—201.

“Written”. Section 1—201.

#### NORTH CAROLINA COMMENT

This section provides a method whereby the assignee of a security interest may indicate the assignment on the record. It is not, however, required as a condition to

the continued perfection of the security interest as to the debtor and his creditors and purchasers. See GS 25-9-302 (2).

**§ 25-9-406. Release of collateral; duties of filing officer; fees.**—A secured party of record may by his signed statement release all or a part of any collateral described in a filed financing statement. The statement of release is sufficient if it contains a description of the collateral being released, the name and address of the debtor, the name and address of the secured party, and the file number of the financing statement. Upon presentation of such a statement to the filing officer he shall mark the statement with the hour and date of filing and shall note the same upon the margin of the index of the filing of the financing statement. The uniform fee for filing and noting such a statement of release shall be a minimum charge of two dollars (\$2.00) for up to and including the first two pages and one dollar (\$1.00) for all over two pages. (1965, c. 700, s. 1.)



## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.

**Purposes:**

Like the preceding section, this section provides a permissive device for noting of record any release of collateral. There is no requirement that such a statement be filed when collateral is released (cf. Section 9-404 on Termination Statements). It is merely a method of making the record reflect the true state of affairs

so that fewer inquiries will have to be made by persons who consult the files.

**Cross reference:**

Section 9-304.

**Definitional cross references:**

"Collateral". Section 9-105.

"Debtor". Section 9-105.

"Financing statement". Section 9-402.

"Secured party". Section 9-105.

"Signed". Section 1-201.

**§ 25-9-407. Information from filing officer.**—(1) If the person filing any financing statement, termination statement, statement of assignment, or statement of release, furnishes the filing officer a copy thereof, the filing officer shall upon request note upon the copy the file number and date and hour of the filing of the original and deliver or send the copy to such person.

(2) Upon request the filing officer shall furnish a copy of any filed financing statement or statement of assignment for a uniform fee of one dollar (\$1.00) per page. (1965, c. 700, s. 1.)

## NORTH CAROLINA COMMENT

This section was optional. However, in view of the innovation of central filing in this State it probably is desirable to have this alternative method for procuring information available to interested parties.

It is true that similar provisions previously existed with reference to the duties of the register of deeds. However, there were probably no provisions applicable to the office of the Secretary of State.

**§ 25-9-408. Recording of financing statement and security agreement in lieu of filing.**—(1) In the event any secured party desires to record his original security agreement in lieu of filing a financing statement or filing the original security agreement, he may present said original security agreement for recording by the register of deeds in the same manner and for the same uniform fees prescribed under § 25-9-403, and the recording of such agreement by the register of deeds and the return of the original thereof to the secured party in the same manner as the filing of a financing statement under this article shall have the same effect as the filing of such financing statement.

(2) The register of deeds of any county desiring to record all financing statements and security agreements under this article in lieu of the filing thereof as provided herein, by making a copy of such statement or agreement and indexing such statement or agreement as provided in this article may make such election to record in lieu of filing the original thereof by giving notice to the Secretary of State of such election, and the approval thereof by the board of county commissioners of such county, and the Secretary of State shall thereupon show in the public records that said county shall thereafter be a recording county under this article rather than a filing county. In such recording counties the register of deeds shall return the original financing statement or security agreement to the owner thereof upon recording same in the books and indexes of such county. In any such recording county any person so desiring may present duplicate originals of such financing statement or security agreement at the time of recording and may leave one with the register of deeds and have the other marked "filed and recorded" and returned to the person so filing. (1965, c. 700, s. 1.)

**Editor's Note.**—There is no section in the 1962 Official Text of the UCC comparable to this section.

## PART 5.

## DEFAULT.

**§ 25-9-501. Default; procedure when security agreement covers both real and personal property.**—(1) When a debtor is in default under a security agreement, a secured party has the rights and remedies provided in this part and except as limited by subsection (3) those provided in the security agreement. He may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure. If the collateral is documents the secured party may proceed either as to the documents or as to the goods covered thereby. A secured party in possession has the rights, remedies and duties provided in § 25-9-207. The rights and remedies referred to in this subsection are cumulative.

(2) After default, the debtor has the rights and remedies provided in this part, those provided in the security agreement and those provided in § 25-9-207.

(3) To the extent that they give rights to the debtor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied except as provided with respect to compulsory disposition of collateral (subsection (1) of § 25-9-505) and with respect to redemption of collateral (§ 25-9-506) but the parties may by agreement determine the standards by which the fulfillment of these rights and duties is to be measured if such standards are not manifestly unreasonable:

(a) subsection (2) of § 25-9-502 and subsection (2) of § 25-9-504 insofar as they require accounting for surplus proceeds of collateral;

(b) subsection (3) of § 25-9-504 and subsection (1) of § 25-9-505 which deal with disposition of collateral;

(c) subsection (2) of § 25-9-505 which deals with acceptance of collateral as discharge of obligation;

(d) § 25-9-506 which deals with redemption of collateral; and

(e) subsection (1) of § 25-9-507 which deals with the secured party's liability for failure to comply with this part.

(4) If the security agreement covers both real and personal property, the secured party may proceed under this part as to the personal property or he may proceed as to both the real and the personal property in accordance with his rights and remedies in respect of the real property in which case the provisions of this part do not apply.

(5) When a secured party has reduced his claim to judgment the lien of any levy which may be made upon his collateral by virtue of any execution based upon the judgment shall relate back to the date of the perfection of the security interest in such collateral. A judicial sale, pursuant to such execution, is a foreclosure of the security interest by judicial procedure within the meaning of this section, and the secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this article. (1866-7, c. 1, s. 2; 1872-3, c. 133, s. 2; 1883, c. 88; Code, s. 1800; 1893, c. 9; Rev., s. 2054; C. S., s. 2488; 1961, c. 574; 1965, c. 700, s. 1.)

**As to former summary proceeding to enforce agricultural lien,** see *Thomas v. Campbell*, 74 N.C. 787 (1876); *Gay v. Nash*,

84 N.C. 334 (1881); *Cottingham & Bros. v. McKay*, 86 N.C. 241 (1882).

## OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 6, Uniform Trust Receipts Act; Sections 16 through 26, Uniform Conditional Sales Act.

**Changes:** Modified to conform to the scheme of this Article.

**Purposes of changes:**

1. The rights of the secured party in

the collateral after the debtor's default are of the essence of a security transaction. These are the rights which distinguish the secured from the unsecured lender. This section and the following six sections state those rights as well as the limitations on their free exercise which legislative policy requires for the protec-

tion not only of the defaulting debtor but of other creditors. But subsections (1) and (2) make it clear that the statement of rights and remedies in this Part does not exclude other remedies provided by agreement.

2. Following default and the taking possession of the collateral by the secured party, there is no longer any distinction between the security interest which before default was non-possessory and that which was possessory under a pledge. Therefore no general distinction is taken in this Part between the rights of a non-possessory secured party and those of a pledgee; the latter, being in possession of the collateral at default, will of course not have to avail himself of the right to take possession under Section 9—503.

3. Section 9—207 states rights, remedies and duties with respect to collateral in the secured party's possession. That section applies not only to the situation where he is in possession before default, as a pledgee, but also, by subsections (1) and (2) of this section, to the secured party in possession after default. Nevertheless the relations of the parties have been changed by default, and Section 9—207 as it applies after default must be read together with this Part. In particular, agreements permitted under Section 9—207 cannot waive or modify the rights of the debtor contrary to subsection (3) of this section.

4. Section 1—102(3) states rules to determine which provisions of this Act are mandatory and which may be varied by agreement. In general, provisions which relate to matters which come up between immediate parties may be varied by agreement. In the area of rights after default our legal system has traditionally looked with suspicion on agreements designed to cut down the debtor's rights and free the secured party of his duties: no mortgage clause has ever been allowed to clog the equity of redemption. The default situation offers great scope for overreaching; the suspicious attitude of the courts has been grounded in common sense.

Subsection (3) of this section contains a codification of this long-standing and deeply rooted attitude: the specified rights of the debtor and duties of the secured party may not be waived or varied except as stated. Provisions not specified in subsection (3) are subject to the general rules stated in Section 1—102(3).

5. The collateral for many corporate security issues consists of both real and personal property. In the interest of sim-

licity and speed subsection (4) permits, although it does not require, the secured party to proceed as to both real and personal property in accordance with his rights and remedies in respect of the real property. Except for the permission so granted, this Act leaves to other state law all questions of procedure with respect to real property. For example, this Act does not determine whether the secured party can proceed against the real estate alone and later proceed in a separate action against the personal property in accordance with his rights and remedies against the real estate. By such separate actions the secured party "proceeds as to both," and this Part does not apply in either action. But subsection (4) does give him an option to proceed under this Part as to the personal property.

6. Under subsection (1) a secured party is entitled to reduce his claim to judgment or to foreclose his interest by any available procedure, outside this Article, which state law may provide. The first sentence of subsection (5) makes clear that any judgment lien which the secured party may acquire against the collateral is, so to say, a continuation of his original interest (if perfected) and not the acquisition of a new interest or a transfer of property to satisfy an antecedent debt. The judgment lien is therefore stated to relate back to the date of perfection of the security interest. The second sentence of the subsection makes clear that a judicial sale following judgment, execution and levy is one of the methods of foreclosure contemplated by subsection (1); such a sale is governed by other law and not by this Article and the restrictions which this Article imposes on the right of a secured party to buy in the collateral at a sale under Section 9—504 do not apply.

#### Cross references:

- Point 2: Section 9—503.
- Point 3: Section 9—207.
- Point 4: Section 1—102(3).
- Point 5: Sections 9—102(1) and 9—104(j).
- Point 6: Section 9—504.

#### Definitional cross references:

- "Agreement". Section 1—201.
- "Collateral". Section 9—105.
- "Debtor". Section 9—105.
- "Documents". Section 9—105.
- "Goods". Section 9—105.
- "Remedy". Section 1—201.
- "Rights". Section 1—201.
- "Secured party". Section 9—105.
- "Security agreement". Section 9—105.
- "Security interest". Section 1—201.



## NORTH CAROLINA COMMENT

This section provides for the basic rights and remedies of the secured party and debtor with reference to the collateral after a default has been made on the underlying obligation.

Subsection (1) reserves to the secured party any methods of judicial enforcement which prior law granted. This, where applicable, permits equitable foreclosure or other judicial action to secure possession of and provide for sale of the property. In addition, the secured party may proceed as any other creditor to reduce his claim to judgment without reference to the collateral. Subsection (5) provides that where this is done, the subsequent levy or attachment lien which the secured party, as judgment creditor, procures on the collateral in which he has a security interest relates back to the date of original perfection for the security interest. This provision is de-

signed to minimize preference problems should the debtor subsequently be forced into bankruptcy.

In addition the secured party has the rights granted by the other sections in this Part, such as the right to take possession of the collateral, GS 25-9-503, and hold a sale for disposition thereof. GS 25-9-504.

The judicial remedies which the secured party has under North Carolina law with enactment of the Code, are at least an action for claim and delivery of the goods, *Buffkins v. Eason*, 112 N.C. 162, 16 S.E. 916 (1893), and probably an action to foreclose. See *Hackley Piano Co. v. Kennedy*, 152 N.C. 196, 67 S.E. 488 (1910).

As to the rights of the secured party upon default under trust receipts, see GS 45-51 and North Carolina Comment to GS 25-9-504.

**§ 25-9-502. Collection rights of secured party.**—(1) When so agreed and in any event on default the secured party is entitled to notify an account debtor or the obligor on an instrument to make payment to him whether or not the assignor was theretofore making collections on the collateral, and also to take control of any proceeds to which he is entitled under § 25-9-306.

(2) A secured party who by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor and who undertakes to collect from the account debtors or obligors must proceed in a commercially reasonable manner and may deduct his reasonable expenses of realization from the collections. If the security agreement secures an indebtedness, the secured party must account to the debtor for any surplus, and unless otherwise agreed, the debtor is liable for any deficiency. But, if the underlying transaction was a sale of accounts, contract rights or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides. (1961, c. 574; 1965, c. 700, s. 1.)

## OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. The assignee of accounts, chattel paper, contract rights or instruments holds as collateral property which is not only the most liquid asset of the debtor's business but also property which may be collected without any interruption of the business, assuming it to continue after default. The situation is far different from that where the collateral is inventory or equipment, whose removal may bring the business to a halt. Furthermore the problems of valuation and identification, present where the collateral is tangible chattels, do not arise so sharply on the assignment of intangibles. Considerations, similar although not identical, apply to assignments of general intangibles, which are also covered by the rule of the section. Consequently, this section recognizes the fact that financing by assignment of

intangibles lacks many of the complexities which arise after default in other types of financing, and allows the assignee to liquidate in the regular course of business by collecting whatever may become due on the collateral, whether or not the method of collection contemplated by the security arrangement before default was direct (i. e., payment by the account debtor to the assignee, "notification" financing) or indirect (i. e., payment by the account debtor to the assignor, "non-notification" financing). By agreement, of course, the secured party may have the right to give notice and to make collections before default.

2. In one form of accounts receivable financing, which is found in the "factoring" arrangements which are in the textile industry, the assignee assumes the credit risk—that is, he buys the account under an agreement which does not pro-

vide for recourse or charge-back against the assignor in the event the account proves uncollectible. Under such an arrangement, neither the debtor nor his creditors have any legitimate concern with the disposition which the assignee makes of the accounts. Under another form of accounts receivable financing, however, the assignee does not assume the credit risk and retains a right of full or limited recourse or charge-back for uncollectible accounts. In such a case both debtor and creditors have a right that the assignee not dump the accounts, if the result will be to increase a possible deficiency claim or to reduce a possible surplus.

3. Where an assignee has a right of charge-back or a right of recourse, subsection (2) provides that liquidation must be made with due regard to the interest of the assignor and of his other creditors—"in a commercially reasonable manner" (compare Section 9-504 and see Section 9-507(2))—and the proceeds allocated to the expenses of realization and to the indebtedness. If the "charge-back" provisions of the assignment arrangement provide only for "charge-back" of bad accounts against a reserve, the debtor's claim to surplus and his liability for a deficiency are limited to the amount of the reserve.

4. Financing arrangements of the type dealt with by this section are between business men. The last sentence of subsection (2) therefore preserves freedom of contract, and the subsection recognizes that there may be a true sale of accounts, chattel paper, or contract rights although recourse exists. The determination whether a particular assignment constitutes a sale or a transfer for security is left to the courts. Note that, under Section 9-102, this Article applies both to sales and to security transfers of such intangibles.

**Cross references:**

Sections 9-205 and 9-306.

Point 3: Sections 9-504 and 9-507(2).

Point 4: Sections 9-102(1) (b) and 9-104(f).

**Definitional cross references:**

"Account" Section 9-106.

"Account debtor". Section 9-105.

"Agreement" Section 1-201.

"Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Contract right". Section 9-106.

"Debtor" Section 9-105.

"Instrument" Section 9-105.

"Notify" Section 1-201.

"Proceeds". Section 9-306.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

**§ 25-9-503. Secured party's right to take possession after default.—**

Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under § 25-9-504. (1961, c. 574; 1965, c. 700, s. 1.)

**OFFICIAL COMMENT**

**Prior uniform statutory provision:** Section 6, Uniform Trust Receipts Act; Sections 16 and 17, Uniform Conditional Sales Act.

**Changes:** Modified to conform to the scheme of this Article.

**Purposes of changes:**

Under this Article the secured party's right to possession of the collateral (if he is not already in possession as pledgee) accrues on default unless otherwise agreed in the security agreement. This Article follows the provisions of the earlier uniform legislation in allowing the secured party in most cases to take possession without the issuance of judicial process. In the case of collateral such as heavy equipment, the physical removal from the debtor's plant and the storage of the

equipment pending resale may be exceedingly expensive and in some cases impractical. The section therefore provides that in lieu of removal the lender may render equipment unusable or dispose of collateral on the debtor's premises. The authorization to render equipment unusable or to dispose of collateral without removal would not justify unreasonable action by the secured party, since, under Section 9-504(3), all his actions in connection with disposition must be taken in a "commercially reasonable manner".

**Cross reference:**

Section 9-504.

**Definitional cross references:**

"Action" Section 1-201

"Collateral" Section 9-105.

"Debtor". Section 9-105.

"Equipment". Section 9—109.

"Party". Section 1—201.

"Rights". Section 1—201.

"Secured party". Section 9—105.

"Security agreement". Section 9—105.

#### NORTH CAROLINA COMMENT

By implication, this section gives the debtor the right to possession of the collateral before default, unless the parties agree otherwise. This is in accord with a recent North Carolina statute relating to installment sales, GS 45-3.1, and the Uniform Trust Receipts Act, GS 45-51.

The second sentence of this section gives the secured party the right to take possession of the collateral upon default without aid of judicial process provided he commits no breach of peace. This is in accord with prior North Carolina law. *Rea v. Universal C.I.T. Credit Corp.*, 257 N.C. 639, 127

S.E.2d 225 (1962). Further, this section implies that the secured party may enter the premises of the debtor to secure possession of the collateral if entry can be made without causing a breach of peace. Whether this could be done in North Carolina, in the absence of an express agreement to that effect, was not clear. See *Rea v. Universal C.I.T. Credit Corp.*, 257 N.C. 639, 127 S.E.2d 225 (1962).

No North Carolina cases dealing with the provisions of the third and fourth sentences of this section have been found.

**§ 25-9-504. Secured party's right to dispose of collateral after default; effect of disposition.**—(1) A secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing. Any sale of goods is subject to the article on sales (article 2). The proceeds of disposition shall be applied in the order following to

(a) the reasonable expenses of retaking, holding, preparing for sale, selling and the like and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorneys' fees and legal expenses incurred by the secured party;

(b) the satisfaction of indebtedness secured by the security interest under which the disposition is made;

(c) the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand therefor is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.

(2) If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus, and, unless otherwise agreed, the debtor is liable for any deficiency. But if the underlying transaction was a sale of accounts, contract rights, or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

(3) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, and except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or who is known by the secured party to have a security interest in the collateral. The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale.

(4) When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges



the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interests even though the secured party fails to comply with the requirements of this part or of any judicial proceedings

(a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith.

(5) A person who is liable to a secured party under a guaranty, indorsement, repurchase agreement or the like and who receives a transfer of collateral from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party. Such a transfer of collateral is not a sale or disposition of the collateral under this article. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 6, Uniform Trust Receipts Act; Sections 19, 20, 21, and 22, Uniform Conditional Sales Act.

**Changes:** Modified to conform to the scheme of this Article.

#### Purposes of changes:

1. The Uniform Trust Receipts Act provides that an entruster in possession after default holds the collateral with the rights and duties of a pledgee, and, in particular, that he may sell such collateral at public or private sale with a right to claim deficiency and a duty to account for any surplus. The Uniform Conditional Sales Act insisted on a sale at public auction with elaborate provisions for the giving of notice of sale. This section follows the more liberal provisions of the Trust Receipts Act. Although public sale is recognized, it is hoped that private sale will be encouraged where, as is frequently the case, private sale through commercial channels will result in higher realization on collateral for the benefit of all parties. The only restriction placed on the secured party's method of disposition is that it must be commercially reasonable. In this respect this section follows the provisions of the section on resale by a seller following a buyer's rejection of goods (Section 2—706). Subsection (1) does not restrict disposition to sale: the collateral may be sold, leased, or otherwise disposed of—subject of course to the general requirement of subsection (2) that all aspects of the disposition be “commercially reasonable”. Section 9—507(2) states some tests as to what is “commercially reasonable”.

2. Subsection (1) in general follows prior law in its provisions for the application of proceeds and for the debtor's right to surplus and liability for deficiency. Under subsection (1) (c) the secured party, after paying expenses of retaking and disposition and his own debt, is re-

quired to pay over remaining proceeds to the extent necessary to satisfy the holder of any junior security interest in the same collateral if the holder of the junior interest has made a written demand and furnished on request reasonable proof of his interest: this provision is necessary in view of the fact that under subsection (4) the junior interest is discharged by the disposition. Since the requirement is conditioned on written demand it should not result in undue burden on the secured party making the disposition. It should be noted that under Section 9—112 where the secured party knows that the collateral is owned by a person who is not the debtor, the owner of the collateral and not the debtor is entitled to any surplus.

3. In any security transaction the debtor (or the owner of the collateral if other than the debtor: see Section 9—112) is entitled to any surplus which results from realization on the collateral; the debtor will also, unless otherwise agreed, be liable for any deficiency. Subsection (2) so provides. Since this Article covers sales of certain intangibles as well as transfers for security, the subsection also provides that apart from agreement the right to surplus or liability for deficiency does not accrue where the transaction between debtor and secured party was a sale and not a security transaction.

4. Subsection (4) provides that a purchaser for value from a secured party after default takes free of any rights of the debtor and of the holders of junior security interests and liens, even though the secured party has not complied with the requirements of this Part or of any judicial proceedings. This subsection follows a similar provision in the Uniform Trust Receipts Act and in the section of this Act on resale by a seller (Section 2—706). Where the purchaser for value has bought at a public sale he is protected under paragraph (a) if he has no

knowledge of any defects in the sale and was not guilty of collusive practices. Where the purchaser for value has bought at a private sale he must, to receive the protection of paragraph (b), qualify in all respects as a purchaser in good faith. Thus while the purchaser at a private sale is required to proceed in the exercise of good faith, the purchaser at public sale is protected so long as he is not actively in bad faith, and is put under no duty to inquire into the circumstances of the sale.

5. Both the Uniform Trust Receipts Act and the Uniform Conditional Sales Act required a waiting period after repossession and before sale (five days in the Trust Receipts Act, ten days in the Conditional Sales Act). Under subsection (3) the secured party in most cases is required to give reasonable notification of disposition both to the debtor and (except for consumer goods) to other secured parties who have filed in this state or are known to him. Except for the requirement of notification there is no statutory period during which the collateral must be held before disposition. "Reasonable notification" is not defined in this Article; at a minimum it must be sent in such time that persons entitled to receive it will have sufficient time to take appropriate steps to protect their interests by taking part in the sale or other disposition if they so desire.

6. Section 19 of the Uniform Conditional Sales Act required that sale be made not more than thirty days after possession taken by the conditional vendor. The Uniform Trust Receipts Act contained no comparable provision. Here again this Article follows the Trust Receipts Act, and no period is set within which the disposition must be made, except in the case of consumer goods which under Section 9-505(1) must in certain instances be sold within ninety days after the secured party has taken possession. The failure to prescribe a statutory period during which disposition must be made is in line with the policy adopted in this Article to encourage disposition by private sale through regular commercial channels. It may, for example, be wise not to dispose

of goods when the market has collapsed, or to sell a large inventory in parcels over a period of time instead of in bulk. Note, however, that under subsection (3) every aspect of the sale or other disposition of the collateral must be commercially reasonable; this specifically includes method, manner, time, place and terms. See Section 9-507(2). Under that provision a secured party who without proceeding under Section 9-505(2) held collateral a long time without disposing of it, thus running up large storage charges against the debtor, where no reason existed for not making a prompt sale, might well be found not to have acted in a "commercially reasonable" manner. See also Section 1-203 on the general obligation of good faith.

#### Cross references:

Point 1: Sections 2-706 and 9-507(2).

Point 2: Section 9-112.

Point 3: Sections 9-102(1) (b) and 9-112.

Point 4: Section 2-706.

Point 6: Sections 9-505 and 9-507(2).

#### Definitional cross references:

"Account". Section 9-106.

"Agreement". Section 1-201.

"Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Consumer goods". Section 9-109.

"Contract". Section 1-201.

"Contract right". Section 9-106.

"Debtor". Section 9-105.

"Financing statement". Section 9-402.

"Gives" notification. Section 1-201.

"Good faith". Section 1-201.

"Goods". Section 9-105.

"Knowledge". Section 1-201.

"Person". Section 1-201.

"Proceeds". Section 9-306.

"Purchaser". Section 1-201.

"Receives" notification. Section 1-201.

"Rights". Section 1-201.

"Sale". Sections 2-106 and 9-105.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Send". Section 1-201.

"Term". Section 1-201.

"Value". Section 1-201.

"Written". Section 1-201.

### NORTH CAROLINA COMMENT

This section gives the secured party the right to sell collateral after default, unless the power of sale is modified or prohibited by the security agreement. Under prior law relating to chattel mortgages and conditional sales, the secured party had a power of sale whether or not the security agreement provided expressly for the

power. GS 45-21.18. Accord: GS 45-51 (trust receipts).

*Subsection (1):* The priority in disposition of the proceeds of the sale set out in subsection (1) is in accord with prior law. That is, where the secured party sold personal property pursuant to the power of sale, the proceeds thereof were applied

first to the "costs and expenses of the sale," GS 45-21.31 (a) (1), and then to the obligation secured by the mortgage. GS 45-21.31 (a) (4). There was no express provision in the prior statutes like that of subsection (1) (c), but prior law required the mortgagee to turn over the surplus to the "party entitled thereto," who presumably could be a junior lienholder. GS 45-21.31 (b).

*Subsection (2)*, in giving the debtor the right to any ultimate surplus of the proceeds, is in accord with prior law. However, there was no provision in the prior statutes which would except accounts, contract rights, or chattel paper.

*Subsection (3)* provides for the methods of sale. Under prior law, rather elaborate provisions for notice to the debtor had to be complied with and a public sale had to be held. GS 45-21.18. See also *Rea v. Universal C.I.T. Credit Corp.*, 257 N.C. 639, 127 S.E.2d 225 (1962); GS 45-51 (trust receipts) (public or private sale may be held). The Code substitutes in place of these rigid requirements the standard of "commercial reasonableness" on the assumption that in most instances the collateral will bring a higher price if the secured party has some flexibility in the method of disposition. If, under the Code, it should be determined that the secured party did not act in a reasonable manner in the conduct of the sale, GS 25-9-507 gives the debtor an express remedy.

Prior law required at least ten days' notice to the debtor in the case of conditional sales and chattel mortgages, five days' notice in the case of trust receipts, subject to the right of the parties to agree otherwise. Under the Code, "reasonable notification" is required. The Official Comment explains that this is notice sufficient to enable the persons entitled thereto to participate in the sale or otherwise pro-

tect their interests. Thus, as a practical matter, the Code requirement of notice probably does not make significant revision in prior law. Further, prior law provided for an exception in the notice requirement in the case of perishable goods, GS 45-21.19, as does the Code. However, the prior exception applied to any collateral which was likely to decline in value.

The last sentence of subsection (3) provides that the secured party may purchase any collateral at a public sale, and certain types of collateral at a private sale. Accord: GS 45-51 (trust receipts). This is contrary to prior North Carolina law relating to chattel mortgages. "(A) mortgagee with power to sell, cannot directly or indirectly purchase at his own sale. This is not because there is, but because there may be fraud." *Harris v. Hillard*, 221 N.C. 329, 20 S.E.2d 278 (1942).

*Subsection (4)* provides that a sale by a secured party transfers to a purchaser for value all of the debtor's rights in the collateral and discharges any security interest subordinate thereto. This is probably contrary to prior North Carolina law. However, the discharge of the security interest is offset by the obligation of the seller to pay the surplus to a junior lienholder, subsection (1) (c), and the seller's liability under GS 25-9-507 for failure to do so in proper circumstances. Further, this subsection provides that a purchaser for value without knowledge of defects will get good title to the goods even though the seller did not comply with the requirements of sale. This probably changes prior law relating to chattel mortgages. See *Ferebee v. Sawyer*, 167 N.C. 199, 83 S.E. 17 (1914) (buyer gets no title where real estate mortgage foreclosure sale is defective). The Trust Receipts Act, GS 45-51, was in accord with the Code.

**§ 25-9-505. Compulsory disposition of collateral; acceptance of the collateral as discharge of obligation.**—(1) If the debtor has paid sixty per cent (60%) of the cash price in the case of a purchase money security interest in consumer goods or sixty per cent (60%) of the loan in the case of another security interest in consumer goods, and has not signed after default a statement renouncing or modifying his rights under this part a secured party who has taken possession of collateral must dispose of it under § 25-9-504 and if he fails to do so within ninety days after he takes possession the debtor at his option may recover in conversion or under § 25-9-507 (1) on secured party's liability.

(2) In any other case involving consumer goods or any other collateral a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor and except in the case of consumer goods to any other secured party who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or is known by the secured party in



possession to have a security interest in it. If the debtor or other person entitled to receive notification objects in writing within thirty days from the receipt of the notification or if any other secured party objects in writing within thirty days after the secured party obtains possession the secured party must dispose of the collateral under § 25-9-504. In the absence of such written objection the secured party may retain the collateral in satisfaction of the debtor's obligation. (1965, c. 700 s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 23, Uniform Conditional Sales Act.

**Changes:** Modified to conform to the scheme of this Article.

##### Purposes of changes:

1. Experience has shown that the parties are frequently better off without a resale of the collateral; hence this section sanctions an alternative arrangement. In lieu of resale or other disposition, the secured party may propose under subsection (2) that he keep the collateral as his own, thus discharging the obligation and abandoning any claim for a deficiency. This right may not be exercised in the case of consumer goods where the debtor has paid 60% of the price or obligation and thus has a substantial equity, and may be exercised in other cases only on notification to the debtor and other secured parties who have filed in this state or are otherwise known to the secured party exercising the right, and on failure of anyone receiving notification to object within thirty days.

2. When an objection is received by the secured party he must then proceed to dispose of the collateral in accordance with Section 9-504, and on failure to do so would incur the liabilities set out in Section 9-507. In the case of consumer

goods where 60% of the price or obligation has been paid the disposition must be made within 90 days after possession taken. For failure to make the sale within the 90 day period the secured party is liable in conversion or alternatively may incur the liabilities set out in Section 9-507.

3. After default (but not before) a consumer-debtor who has paid 60% of the cash price may sign a written renunciation of his rights to require resale of the collateral.

##### Cross references:

Sections 9-504 and 9-507(1).

##### Definitional cross references:

"Collateral". Section 9-105.

"Consumer goods". Section 9-109.

"Debtor". Section 9-105.

"Knows". Section 1-201.

"Notice". Section 1-201.

"Person". Section 1-201.

"Purchase money security interest". Section 9-107.

"Receives" notification. Section 1-201.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Send". Section 1-201.

"Signed". Section 1-201.

"Written". Section 1-201.

**§ 25-9-506. Debtor's right to redeem collateral.**—At any time before the secured party has disposed of collateral or entered into a contract for its disposition under § 25-9-504 or before the obligation has been discharged under § 25-9-505(2) the debtor or any other secured party may, unless otherwise agreed in writing, after default, redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorneys' fees and legal expenses. (1965, c. 700, s. 1.)

#### OFFICIAL COMMENT

**Prior uniform statutory provision:** Section 18, Uniform Conditional Sales Act.

**Changes:** Modified to conform to the scheme of this Article.

##### Purpose of changes:

Except in the case stated in Section 9-505(1) (consumer goods) the secured party is not required to dispose of collateral within any stated period of time. Under this section so long as the secured party has not disposed of collateral in his

possession or contracted for its disposition, and so long as his right to retain it has not become fixed under Section 9-505(2), the debtor or another secured party may redeem. The debtor must tender fulfillment of all obligations secured, plus certain expenses: if the agreement contains a clause accelerating the entire balance due on default in one installment, the entire balance would have to be tendered. "Tendering fulfillment" obviously

means more than a new promise to perform the existing promise; it requires payment in full of all monetary obligations then due and performance in full of all other obligations then matured. If unmatured obligations remain, the security interest continues to secure them as if there had been no default.

Under Section 9—504 the secured party may make successive sales of parts of the collateral in his possession. The fact that he may have sold or contracted to sell part of the collateral would not affect the debtor's right under this section to

redeem what was left. In such a case, of course, in calculating the amount required to be tendered the debtor would receive credit for net proceeds of the collateral sold.

**Cross references:**

Sections 9—504 and 9—505.

**Definitional cross references:**

"Agreement". Section 1—201.

"Collateral". Section 9—105.

"Contract". Section 1—201.

"Debtor". Section 9—105.

"Secured party". Section 9—105.

"Writing". Section 1—201.

### NORTH CAROLINA COMMENT

This section is similar in purpose to GS 45-21.20, which gives the mortgagor or conditional vendor a right to redeem the collateral by payment of the debt and the

expenses incurred with respect to the proposed sale at any time before the sale is held.

**§ 25-9-507. Secured party's liability for failure to comply with this part.**—(1) If it is established that the secured party is not proceeding in accordance with the provisions of this part disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this part. If the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus ten per cent (10%) of the principal amount of the debt or the time price differential plus ten per cent (10%) of the cash price.

(2) The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner. The principles stated in the two preceding sentences with respect to sales also apply as may be appropriate to other types of disposition. A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable, but this sentence does not indicate that any such approval must be obtained in any case nor does it indicate that any disposition not so approved is not commercially reasonable. (1965, c. 700, s. 1.)

### OFFICIAL COMMENT

**Prior uniform statutory provision:** None.  
**Purposes:**

1. The principal limitation on the secured party's right to dispose of collateral is the requirement that he proceed in good faith (Section 1—203) and in a commercially reasonable manner. See Section 9—504. In the case where he proceeds, or is about to proceed, in a contrary manner, it is vital both to the debtor and other creditors to provide a remedy for the failure to comply with the statutory duty. This remedy will be

of particular importance when it is applied prospectively before the unreasonable disposition has been concluded. This section therefore provides that a secured party proposing to dispose of collateral in an unreasonable manner, may, by court order, be restrained from doing so, and such an order might appropriately provide either that he proceed with the sale or other disposition under specified terms and conditions, or that the sale be made by a representative of creditors where insolvency proceedings have been

instituted. The section further provides for damages where the unreasonable disposition has been concluded, and, in the case of consumer goods, states a minimum recovery.

A case may be put in which the liquidation value of an insolvent estate would be enhanced by disposing of all the debtor's property (including that subject to a security interest) in the liquidation proceeding and in which, if a secured party repossesses and sells that part of the property which he holds as collateral, the remainder will have little or no resale value. In such a case the question may arise whether a particular court has the power to control the manner of disposition, although reasonable in other respects, in order to preserve the estate for the benefit of creditors. Such a power is no doubt inherent in a federal bankruptcy court, and perhaps also in other courts of equity administering insolvent estates. Traditionally it has not been exercised where the secured party claimed under a title retention device, such as conditional sale or trust receipt. See *In re Lake's Laundry, Inc.*, 79 F.2d 326 (2d Cir. 1935) and the remarks of Clark, J., concurring in *In re White Plains Ice Service, Inc.*, 109 F.2d 913 (2d Cir. 1940). But since this Article adopts neither a "title" nor a "lien" theory of security interests (see Section 9-202 and Comment thereto), the granting or denying of, for example, petitions of reclamation in bankruptcy proceedings should not be influenced by speculations as to whether the secured party had "title" to the collateral or "merely a lien".

2. In view of the remedies provided the debtor and other creditors in subsection (1) when a secured party does not dispose of collateral in a commercially reasonable manner it is of great impor-

tance to make clear what types of disposition are to be considered commercially reasonable, and in an appropriate case to give the secured party means of getting, by court order or negotiation with a creditors' committee or a representative of creditors, approval of a proposed method of disposition as a commercially reasonable one. Subsection (2), states rules to assist in the determination, and provides for such advance approval in appropriate situations. One recognized method of disposing of repossessed collateral is for the secured party to sell the collateral to or through a dealer—a method which in the long run may realize better average returns since the secured party does not usually maintain his own facilities for making such sales. Such a method of sale, fairly conducted, is recognized as commercially reasonable under the second sentence of subsection (2). However, none of the specific methods of disposition set forth in subsection (2) is to be regarded as either required or exclusive, provided only that the disposition made or about to be made by the secured party is commercially reasonable.

#### Cross references:

Point 1: Sections 1-203, 9-202 and 9-504.

#### Definitional cross references:

"Collateral". Section 9-105.  
 "Consumer goods". Section 9-109.  
 "Creditor". Section 1-201.  
 "Debtor". Section 9-105.  
 "Knows". Section 1-201.  
 "Notification". Section 1-201.  
 "Person" Section 1-201.  
 "Representative". Section 1-201.  
 "Rights". Section 1-201.  
 "Secured party". Section 9-105.  
 "Security interest". Section 1-201.

### NORTH CAROLINA COMMENT

This section gives the debtor rights against the secured party for failure to comply with this Part and sets forth some standards to be used in determining whether the secured party has in fact com-

plied. It is similar in purpose to prior law. See *Rea v. Universal C.I.T. Credit Corp.*, 257 N.C. 639, 127 S.E.2d 225 (1962) (secured party liable for failure to comply with provisions for public sale).

### ARTICLE 10.

#### *Effective Date and Repealer.*

§ 25-10-101. **Effective date.**—This act shall become effective at midnight on June 30, 1967. It applies to transactions entered into and events occurring after that date. (1965, c. 700, s. 11.)

### OFFICIAL COMMENT

This effective date is suggested so that there may be ample time for all those

who will be affected by the provisions of the Code to become familiar with them.



**§ 25-10-102. Specific repealer; provision for transition.**—(1) The following acts and all other acts and parts of acts inconsistent herewith are hereby repealed:

Uniform Negotiable Instruments Act, G.S. 25-1 through G.S. 25-199.

Uniform Warehouse Receipts Act, G.S. 27-1 through G.S. 27-53.

Uniform Bills of Lading Act, G.S. 21-1 through G.S. 21-41.

Uniform Stock Transfer Act, G.S. 55-75 through G.S. 55-98.

Uniform Trust Receipts Act, G.S. 45-46 through G.S. 45-66.

Agricultural liens for advances, G.S. 44-52 through G.S. 44-64.

Bank collections, G.S. 53-57 and 53-58.

Bulk sales, G.S. 39-23.

Factor's lien acts, G.S. 44-70 through G.S. 44-76.

Assignment of accounts receivable, G.S. 44-77 through G.S. 44-85.

(2) Transactions validly entered into before July 1, 1967, and the rights, duties and interests flowing from them remain valid thereafter and may be terminated, completed, consummated or enforced as required or permitted by any statute or other law amended or repealed by this act as though such repeal or amendment had not occurred. (1965, c. 700, s. 2.)

#### OFFICIAL COMMENT

Subsection (1) provides for the repeal of present uniform and other acts super-

seded by this Act. Subsection (2) provides for the transition to the Code.

**§ 25-10-103. General repealer.**—Except as provided in the following section, all acts and parts of acts inconsistent with this act are hereby repealed. (1965, c. 700, s. 1.)

**Editor's Note.**—Section 6, c. 700, Session Laws 1965, reads "the following sections 7 and 8" instead of "the following section" as in the 1962 Official Text of

the uniform act. Section 7 of c. 700 is codified as § 25-10-104 (the following section) and § 8 amends §§ 47-20 and 47-20.2 of the General Statutes.

#### OFFICIAL COMMENT

This section provides for the repeal of all other legislation inconsistent with this Act.

**§ 25-10-104. Laws not repealed.**—(1) The article on documents of title (article 7) does not repeal or modify any laws prescribing the form or contents of documents of title or the services or facilities to be afforded by bailees, or otherwise regulating bailees' businesses in respects not specifically dealt with herein; but the fact that such laws are violated does not affect the status of a document of title which otherwise complies with the definition of a document of title (§ 25-1-201).

(2) This act does not repeal G.S. 32-14 through G.S. 32-24, cited as the Uniform Act for the Simplification of Fiduciary Security Transfers, and if in any respect there is an inconsistency between that act and the article of this act on investment securities (article 8), the provisions of the former act shall control. (1965, c. 700, s. 7.)

#### OFFICIAL COMMENT

This section subordinates the Article of this Act on Documents of Title (Article 7) to the more specialized regulations of particular classes of bailees under other legislation and international treaties. Particularly, the provisions of that Article are superseded by applicable inconsistent provisions regarding the obligation of carriers and the limitation of their liability found in federal legislation dealing with transportation by water (including the Harter Act, Act of February 13, 1893,

27 Stat. 445, and the Carriage of Goods by Sea Act, Act of April 16, 1936, 49 Stat. 1207); the Warsaw Convention on International Air Transportation, 49 Stat. 3000, and Section 20(11) of the Interstate Commerce Act, Act of February 20, 1887 24 Stat. 386, as amended. The Documents of Title provisions of this Act supplement such legislation largely in matters other than obligation of the bailee, e. g., form and effects of negotiation, procedure in the case of lost docu-

ments, effect of overissue, possibility of rapid transmission.

**Cross reference:**  
Section 7—103.

§ **25-10-105. Remedies for secured party cumulative.**—In case of conflict between chapter 45 of the North Carolina General Statutes and article 9 of the Uniform Commercial Code, the latter shall govern all transactions subject thereto and chapter 45 shall be of no effect, except, that any remedy given by chapter 45 to a secured party as defined in § 25-9-105 of the Uniform Commercial Code, shall be cumulative with the rights and remedies granted by article 9 of the Uniform Commercial Code, but this shall in no way restrict the rights and remedies granted under the Uniform Commercial Code. (1965, c. 700, s. 3.)

**Editor's Note.**—There is no section in the 1962 Official Text of the UCC comparable to this section.

§ **25-10-106. Covered transactions not subject to prior registration statutes.**—Any security interest subject to article 9 of the Uniform Commercial Code and which is perfected by filing or otherwise under the Uniform Commercial Code, article 9, shall not be subject in any way to chapter 47 of the North Carolina General Statutes. (1965, c. 700, s. 4.)

**Editor's Note.**—There is no section in the 1962 Official Text of the UCC comparable to this section.

§ **25-10-107. Excluded transactions subject to existing statutes.** — Security interests which are exempt from the provisions of the Uniform Commercial Code, or which are otherwise not subject to said Code nor affected by its provisions regarding filing and priority, including but not limited to security transactions excluded from the Code under § 25-9-104 and § 25-9-302, shall continue to be subject to the provisions of chapter 45 and chapter 47 of the General Statutes of North Carolina, and other existing statutes. (1965, c. 700, s. 5.)

**Editor's Note.**—There is no section in the 1962 Official Text of the UCC comparable to this section.

## Chapter 26.

### Suretyship.

Sec.	Sec.
26-1. Surety and principal distinguished in judgment and execution.	26-7. Surety, indorser, or guarantor may notify creditor to take action.
26-2. Principal liable on execution before surety.	26-8. Notice; how given; prima facie evidence thereof.
26-3. Summary remedy of surety against principal.	26-9. Effect of failure of creditor to take action.
26-3.1. Surety's recovery on obligation paid; no assignment necessary.	26-10. [Repealed.]
26-4. Subrogation of surety paying debt of deceased principal.	26-11. Cancellation of judgment as to surety.
26-5. Contribution among sureties.	26-12. Joinder of debtor by surety.
26-6. Dissenting surety not liable to surety on stay of execution.	

§ 26-1. **Surety and principal distinguished in judgment and execution.**—In the trial of actions upon contracts either of the defendants may show in evidence that he is surety, and if it be satisfactorily shown, the jury in their verdict, or the justice of the peace in his judgment, shall distinguish the principal and surety, which shall be indorsed on the execution by the clerk or justice of the peace issuing it. (1826, c. 31, s. 1; R. C., c. 31, s. 124; Code, s. 2100; Rev., s. 2840; C. S., s. 3961.)

**Cross Reference.**—As to right of surety to subrogation, see note to § 26-3.

**In General.**—A surety is bound with his principal as an original promisor. *Coleman v. Fuller*, 105 N.C. 328, 11 S.E. 175 (1890).

The surety's promise is to pay a debt, which becomes his own debt when the principal fails to pay it. *Coleman v. Fuller*, 105 N.C. 328, 11 S.E. 175 (1890).

**Construed Strictly.**—The liability of a surety cannot be enlarged by construction. *George D. Witt Shoe Co. v. Peacock*, 150 N.C. 545, 64 S.E. 437 (1909).

**Order of Liability.**—The order in which parties to a security are liable at law, is the order in which, independently of contract, they will be held bound in equity. *Smith v. Smith*, 16 N.C. 173 (1828).

Where it appeared that a negotiable instrument was signed by three persons other than the principal obligor, and it also appeared from a writing executed some time thereafter by one to indemnify the other two that they (the other two) "signed as co-sureties" of the third, it was held, that the character of suretyship in which all three signed was sufficiently established. *Southerland v. Fremont*, 107 N.C. 565, 12 S.E. 237 (1890).

**Same—Parol Evidence to Show Coprincipals.**—In *Williams v. Glenn*, 92 N.C. 253 (1885), the note (under seal) was made with W. "as principal" and B. and G. "as sureties," yet as between the obligors the court held that parol evidence was admissible to show that Boyden and

Glenn were coprincipals, and that the rule of contribution obtained among them. *Smith v. Carr*, 128 N.C. 150, 38 S.E. 732 (1901).

While all of the makers may appear as principals upon the face of the paper, or some principals and some sureties, yet it may be shown that while appearing as principals they were in fact sureties, or some principals and others sureties; and upon the establishment of the fact of co-suretyship, the right of contribution follows. *Smith v. Carr*, 128 N.C. 150, 38 S.E. 732 (1901).

**Same—Issue Submitted.**—In an action against the maker and endorser of a note, an issue should be submitted as to whether or not the endorser was cosurety, or whether one was a supplemental surety to the other. *Parish v. Graham*, 129 N.C. 230, 39 S.E. 825 (1901).

**May Allege and Prove Suretyship.**—When sued, either of the defendants may allege that he is surety, and, if the allegation be proven, the jury in their verdict and the court in the judgment shall distinguish the principal and surety, and it shall be so endorsed on the execution issued for the collection of the judgment. *Bank of Commerce & Trusts v. McArthur*, 261 Fed. 97 (E.D.N.C. 1919).

In *Gatewood v. Leak*, 99 N.C. 357, 6 S.E. 635 (1888), it was said: "If the appellee was surety, as he alleges, he might, as allowed by the statute, (this section) have shown, by proper evidence on the



trial in the actions in which the judgments were obtained by the appellant, that he was such surety, and the jury in their verdict, or the justice of the peace in his judgment, would have distinguished him as surety, and the executions would have been issued with a proper endorsement to that effect; and in that case the sheriff would have levied the sum required to be collected, first, out of the property of the principal if he had sufficient for that purpose."

**Same—Practice of Courts.**—It is not the practice of the courts to see that evidence of suretyship is produced and such fact inserted in the judgment, in the absence of the defendants and without any averment or request on their part. *Morehead Banking Co. v. Duke*, 121 N.C. 110, 28 S.E. 191 (1897).

**Effect of Not Alleging Suretyship.**—In *Bank of Commerce & Trusts v. McArthur*, 261 Fed. 97 (E.D.N.C. 1919), it was said that: "It would not seem that, by failing to set up his suretyship in the action brought by the American National Bank on the note, McArthur lost any equitable rights against McBryde to which he was entitled as surety. It is true, as held in *Gatewood v. Leak*, 99 N.C. 357, 6 S.E. 635 (1888), that the surety, who has failed to set up the fact and have it found as provided by the statute, cannot enjoin the plaintiff in the judgment from proceeding to sell his land for its satisfaction. Neither McArthur nor plaintiffs may enjoin the bank from enforcing its judgment against himself until it has exhausted McBryde's property."

The magistrate is not bound to discriminate except upon the application of, and due proof by, the surety. *Stewart v. Ray*, 26 N.C. 269 (1844).

**Effect of Finding of Jury.**—Where a suit is brought at law against two persons, a finding of the jury that one of the defendants is principal, and the other surety, if binding at all between the parties, does not in equity establish the relation of suretyship. *Lowder v. Noding*, 43 N.C. 208 (1851).

**When Execution Does Not Distinguish.**—Where an execution against two does not distinguish which is principal and which surety, the sheriff has a right to collect it from either; and the sheriff may

collect it from the surety, though the plaintiff in the execution directed him to collect it from the other. *Shuford v. Cline*, 35 N.C. 463 (1852).

**Right of Surety to Subrogation.**—See note to § 26-3.

**Right of Surety to Assign Judgment.**—It was stated in *Barringer v. Boyden*, 52 N.C. 187 (1859): "The right of a surety to keep alive a judgment, which he has paid, by having an assignment made to a stranger for his benefit, is unquestionable. When he advances the money, he has a clear equity (if he desires it) to be subrogated to the rights of the creditor, and to use the creditor's judgment for the purpose of coercing payment against the principal. Whether money advanced in such a way be an extinguishment or a purchase seems to be a question of intention. If it be paid, and nothing be said or done to show a contrary intentment, an extinguishment will be presumed; but if an assignment be made to one not a party, so as to show a purpose to keep it alive, it is sufficient. That a party defendant furnishes the money, and that the assignment is made on a day subsequent to the advancement of the money, can make no difference, provided it was intended, at the time it was advanced, as a purchase and not as a payment." *Bank of Commerce & Trusts v. McArthur*, 261 Fed. 97 (E.D.N.C. 1919).

**Signing on Faith of Creditor's Representations.**—Persons signing a note as surety upon faith in the creditor's representation that another will sign as cosurety, leaving the note with the creditor for that purpose, are not bound thereon to such creditor upon the failure of the fulfillment of the representation. *Bank of Benson v. Jones*, 147 N.C. 419, 61 S.E. 193 (1908).

**Bond Joint and Several on Face.**—Although the bond is joint and several on its face it can be shown by parol that a party thereto is a surety. *Coffey v. Reinhardt*, 114 N.C. 509, 19 S.E. 370 (1894).

**Statute of Limitations.**—If the purchaser of a note before maturity, for value and without notice, subsequently receives notice that a party thereto is a surety and delays action for three years after maturity, the surety will be protected by the three years' statute of limitations. *Coffey v. Reinhardt*, 114 N.C. 509, 19 S.E. 370 (1894).

**§ 26-2. Principal liable on execution before surety.**—When an execution, indorsed as aforesaid, shall come to the hands of any officer for collection, he shall levy on all the property of the principal, or so much thereof as shall be necessary to satisfy the execution, and, for want of sufficient property of the principal, also on the property of the surety, and make sale of all the property of

the principal levied on before that of the surety. (1826, c. 31, s. 2; R. C., c. 31, s. 125; Code, s. 2101; Rev., s. 2841; C. S., s. 3962.)

**Surety's Interest in Collateral.**—The surety is entitled to the benefit of every additional or collateral security which the creditor gets into his hands for the debt for which the surety is bound, as soon as such a security is created, and by what-

ever means the surety's interest in it arises; and the creditor cannot himself, nor by any collusion with the debtor, do any act to impair the security or destroy the surety's interest. *First Nat'l Bank v. Homesley*, 99 N.C. 531, 6 S.E. 797 (1888).

**§ 26-3. Summary remedy of surety against principal.**—Any person who may have paid money for and on account of those for whom he became surety, upon producing to the superior court, or any justice of the peace having jurisdiction of the same, a receipt, and showing that an execution has issued, and he has satisfied the same, and making it appear by sufficient testimony that he has laid out and expended any sum of money as the surety of such person, may move the court or justice of the peace, as the case may be, for judgment against his principal for the amount which he has actually paid; a citation having previously issued against the principal to show cause why execution should not be awarded; and should the principal not show sufficient cause, the court or justice shall award execution against the estate of the principal. (1797, c. 487, s. 1, P. R.; R. C., c. 110, s. 1; Code, s. 2093; Rev., s. 2842; C. S., s. 3963.)

I. General Consideration.

II. Subrogation.

III. Assignments.

#### I. GENERAL CONSIDERATION.

**Editor's Note.**—See 13 N.C.L. Rev. 116.

The words "superior court" used in this section mean the clerk of the superior court. *Bank of No. Wilkesboro v. Wilkesboro Hotel Co.*, 147 N.C. 594, 61 S.E. 570 (1908).

**Cannot Sue in Tort.**—A surety who has paid money for his principal cannot sue him in an action of tort. *Ledbetter v. Torney*, 33 N.C. 294 (1850).

**Citation Issued to Principal.**—This section, providing that a surety who shows that he has paid out money upon a judgment against his principal and himself may have a citation issued to the principal by the clerk to show cause why execution should not be awarded him therefor, is constitutional. *Bank of No. Wilkesboro v. Wilkesboro Hotel Co.*, 147 N.C. 594, 61 S.E. 570 (1908).

**Notice to Corporation to Show Cause.**—A notice issued by a court of competent jurisdiction, served upon the secretary and treasurer of a corporation, to show cause why an execution should not be awarded in favor of a surety who has paid a judgment against the corporation and himself, which sets out the date and amount of the judgment, the relation of the parties, that the surety has actually expended money in payment of said judgment, and that the principal has not reimbursed him, is a compliance with the section. *Bank of No. Wilkesboro v. Wilkesboro*

*Hotel Co.*, 147 N.C. 594, 61 S.E. 570 (1908).

**Validity of Order.**—While, under the section the court may not revive a dormant judgment against the principal and the surety, an order otherwise valid is not rendered void by the addition of the words "that the judgment heretofore rendered is hereby revived, to the end that execution may be issued." The last sentence will be regarded as surplusage. *Bank of No. Wilkesboro v. Wilkesboro Hotel Co.*, 147 N.C. 594, 61 S.E. 570 (1908).

**When Surety Entitled to Action for Money Paid.**—A judgment against a surety will not entitle him to maintain an action for money paid to the use of the defendant, until it has been satisfied. *Hodges v. Armstrong*, 14 N.C. 253 (1831).

To enable a surety to recover for money paid to the use of his principal, he must prove an actual payment in satisfaction of the debt. *Hodges v. Armstrong*, 14 N.C. 253 (1831).

The principal is not obligated to his surety until his surety has made a payment. *American Nat'l Fire Ins. Co. v. Gibbs*, 260 N.C. 681, 133 S.E.2d 669 (1963).

**Right of Surety When Funds Misapplied.**—Where a surety prays a judgment against his principal he may recover any funds wrongfully converted or misapplied by the principal. *Fidelity Co. v. Jordan*, 134 N.C. 236, 46 S.E. 496 (1904).

**Surety Cannot Trace Property.**—A surety who has to pay the debt, has no equity to follow the specific property which the principal debtor purchased with the borrowed money. *Carlton v. Simon-ton*, 94 N.C. 401 (1886).

**Same—Bank Deposits.**—Where the principal debtor borrowed a sum of money, which he deposited in a bank which soon afterwards became insolvent, and the surety had to pay the debt, the surety has no equity to enjoin the principal debtor from collecting the dividends from the insolvent bank, until he can recover a judgment. *Carlton v. Simonton*, 94 N.C. 401 (1886).

**Right against Partnership.** — Where a writ is issued against two copartners for partnership debt, and one of them is arrested and gives bail, such bail, upon being afterwards compelled by due course of law to pay the debt, has no remedy except against the individual for whom he became bail. He has no claim upon the other partner. *Foley v. Robards*, 25 N.C. 177 (1842).

Where one indorsed a note at the request of a member of a firm for the purpose of obtaining money for the use of the firm, and the proceeds were so used, the indorser, upon payment of the note, can recover therefor against the firm, though no member of such firm signed the note. *Springs v. McCoy*, 122 N.C. 628, 29 S.E. 903 (1898).

**When Surety's Liability Barred by Limitations.**—Property mortgaged by an administrator to a surety to secure him against loss may be subjected to payment of estate debts, though the personal liability of the surety is barred. *Hooker v. Yellowley*, 128 N.C. 297, 38 S.E. 889 (1901).

**The obligation of a bond for the forthcoming of property** is only that the property shall be delivered to the officer at the time designated, and not that the execution shall be delivered to the officer at the time designated and not that the execution shall be satisfied; and therefore, if a surety to the forthcoming bond before it is forfeited discharges the execution without the request of his principal, such surety cannot maintain an action against his principal for money expended for the latter's use, although by the payment of the money in satisfaction of the execution the bond was discharged. *Gray v. Bowls*, 18 N.C. 437 (1836).

**When Mortgage Inures to Benefit of Creditors.**—A mortgage given by an administrator to a surety on his bond to secure the latter against loss inures to the benefit of the creditors of the estate. *Hooker v. Yellowley*, 128 N.C. 297, 38 S.E. 889 (1901).

**Bond of Guardian in Suit on Behalf of Ward.**—Where a guardian, having given a bond for the prosecution of a suit by him on behalf of his ward and signed the same

individually, was compelled to pay the costs of the suit out of his individual estate, he cannot recover the same under the provisions of this section, which gives a summary method for reimbursement of a surety who has paid money for another. *Green v. Burgess*, 117 N.C. 495, 23 S.E. 439 (1895).

## II. SUBROGATION.

**Subrogation Explained.** — Subrogation is the substitution of another person in the place of a creditor, so that the former can succeed to the rights of the latter in relation to the debt, and to entitle one to such equitable relief, he must have paid the money upon request or as surety or under some compulsion made necessary by the adequate protection of his own rights. *Liles v. Rogers*, 113 N.C. 197, 18 S.E. 104 (1893).

Legal subrogation is based upon payment and exists where one who has an interest to protect or is secondarily liable makes payment, while conventional subrogation, so named from the convention or agreement of the civil law, is founded upon the agreement of the parties, which really amounts to an equitable assignment. *Liles v. Rogers*, 113 N.C. 197, 18 S.E. 104 (1893); *Commercial & Farmers Bank v. Scotland Neck Bank*, 158 N.C. 238, 73 S.E. 157 (1911); *Journal Publishing Co. v. Barber*, 165 N.C. 478, 81 S.E. 694 (1914); *Joyner v. Reflector Co.*, 176 N.C. 274, 97 S.E. 44 (1918).

The doctrine of equity, by which subsequent cases have been ruled, was first announced in the following terms: "By the fact of payment the surety becomes an equitable assignee of all such securities, and is entitled to have them assigned and delivered up to him by the creditor, in order that he may enforce them for his own reimbursement and exoneration. If, therefore, the creditor refuses to surrender up such securities, the surety may maintain an equitable suit to compel their assignment and surrender." *Bank of Commerce & Trusts v. McArthur*, 261 Fed. 97 (E.D.N.C. 1919).

It is held that an endorser on a note may pay it and demand its delivery, and if the contract has been merged into a judgment, his right is to an assignment of the judgment and to enforce it for his own benefit. The principle is clearly stated by Prof. Langdell: "If payment of a debt be secured by a pledge of the debtor's property, and also by the obligation of a personal surety, and the surety pay the debt, equity will compel the creditor to deliver the pledge to him and not to the debtor, though the latter has a clear legal right to receive



it, the debt being paid and extinguished; i. e., equity destroys the legal right of the debtor, and converts the creditor into a trustee for surety. This is done upon the theory that the debt is not paid by the surety, but is purchased by him, and that he is therefore entitled to the pledge as an incident of the debt. This, however, is only a fiction—a fiction, moreover, which is contrary to law, for the payment by the surety extinguishes the debt. Equity does this under the name of subrogation, and perhaps her best justification is that she borrowed both the name and the thing from the civil law." *Bank of Commerce & Trusts v. McArthur*, 261 Fed. 97 (E.D.N.C. 1919).

**A surety paying the debt of his principal** is entitled to be subrogated to all the rights of the creditors, against a co-surety as well as against the principal, and this includes the right to have a judgment which he has paid assigned to a trustee for his benefit, so as to compel his co-surety to pay his pro rata part. *Peebles v. Gay*, 115 N.C. 38, 20 S.E. 173 (1894).

In *Brandt on Suretyship*, § 347, quoted in *Tripp v. Harris*, 154 N.C. 296, 70 S.E. 470 (1911), it is said: "A surety who pays the debt of his principal is entitled to subrogation to a mortgage given by the principal to the creditor for the security of the debt, and he may, with or without a formal assignment thereof, have the same foreclosed in his own name, for his benefit."

**Where a surety, as such, paid the whole of a debt**, then the section gives him a right of action against co-sureties at law, and also such priority as the creditor would have had as a claimant against his principal's estate. *Holden v. Strickland*, 116 N.C. 185, 21 S.E. 684 (1895).

**Rights Acquired.**—The party for whose benefit the doctrine of subrogation is invoked and exercised can acquire no greater rights than those of the party for whom he is substituted, and if the latter had not a right of recovery the former can acquire none. *Sheldon on Subrogation*, § 6; *Clark v. Williams*, 70 N.C. 679 (1874); *Liles v. Rogers*, 113 N.C. 197, 18 S.E. 104 (1893).

An endorser or surety who pays the indebtedness is subrogated to the rights of the creditor as against the property of the debtor. *Ex parte Pittinger*, 142 N.C. 85, 54 S.E. 845 (1906).

A surety to an administration bond who paid one half of a debt recovered against the insolvent administrator is not subrogated to the rights of the creditor whose debt he paid, but to the right of the administrator for whom he paid it. *Clark v. Williams*, 70 N.C. 679 (1874).

**Same—Liens and Securities.**—A surety who pays the debt is subrogated to all the specific liens and securities which the creditor has against the principal debtor. *Carlton v. Simonton*, 94 N.C. 401 (1886).

**When Doctrine Cannot Be Invoked.**—If a surety pays a judgment and has it entered "satisfied," without having it assigned to a trustee for his benefit, the remedy of subrogation is lost. *Peebles v. Gay*, 115 N.C. 38, 20 S.E. 173 (1894).

Where several or successive obligations of suretyship be not in substance and nature for the same thing, and have no relation to or operation upon each other, the doctrine of subrogation cannot be invoked. *Liles v. Rogers*, 113 N.C. 197, 18 S.E. 104 (1893).

**Same—Corporation Note.**—The endorsers on a note of a corporation secured by mortgage on its property are not entitled to subrogation, either legal or conventional, when it is ascertained that the note was paid by the corporation, and not the endorsers, and where there is evidence that the latter had paid it, the question should be submitted to the jury. *Joyner v. Reflector Co.*, 176 N.C. 274, 97 S.E. 44 (1918).

**Rights of Surety against Party Receiving Money with Full Knowledge.**—A surety company which has been called upon to pay a devastavit committed by its principal, an administrator, is entitled to be subrogated to the rights of the creditor against a party who received the money with knowledge of its wrongful appropriation, and his rights are exactly those of the creditor. *Caviness v. Fidelity Co.*, 140 N.C. 58, 52 S.E. 265 (1905).

**A surety, omitted in the deed of trust to secure the sureties**, is entitled to be subrogated to the rights of his co-sureties pro tanto, if he has paid the debts, and the payees in the notes have a superior equitable right of subrogation to the benefit of any security given by the principal debtor to his sureties. *Wiswall v. Potts*, 58 N.C. 184 (1859); *Harrison v. Styres*, 74 N.C. 290 (1876); *Ijames v. Gaither*, 93 N.C. 358 (1885); *Sherrod v. Dixon*, 120 N.C. 60, 26 S.E. 770 (1897). And this is true whether they knew of it or not. *Matthews v. Joyce*, 85 N.C. 258 (1881); *Blanton & Co. v. Bostic*, 126 N.C. 418, 35 S.E. 1035 (1900).

### III. ASSIGNMENTS.

**Preservation of Lien by Assignment.**—A surety may preserve the lien of judgment against the principal and himself by paying the judgment creditor and having the judgment assigned to a third person for his own benefit; and this also ap-

plies to a judgment against his co-sureties and himself in enforcing an equality of obligation between them. *Fowle v. McLean*, 168 N.C. 537, 84 S.E. 852 (1915).

A surety who pays the amount recovered against him and his principal, or co-sureties, may have the judgment assigned to another in trust for his use, and it will continue in force for his benefit; and he may, upon motion in the cause, have satisfaction of the judgment entered, even against the consent of the assignee. *State v. Hearn*, 109 N.C. 150, 13 S.E. 895 (1891).

**Assignment of Right by Surety.**—Where one of two defendants has paid a joint judgment upon a note against them both, and has the judgment assigned to another for his use, who brings action to recover against the other judgment debtor, he may, as between themselves, show that the defendant in the second action was the principal payee, and that he, the plaintiff, was an endorser, though not pleaded in the original action, and recover the full amount of the judgment he has paid, the action being, in substance, one by the surety on the note to recover against the principal thereon. *Haywood v. Russell*, 182 N.C. 711, 110 S.E. 81 (1921).

**When One Half of Judgment Paid and Other Assigned.** — Where a surety who

paid and had satisfaction entered as to one half of a judgment against himself, his principal and a co-surety, and procured the judgment as to the other half to be assigned to a trustee for his benefit, it was in effect the same as if he had procured the whole judgment to be so assigned. *Peebles v. Gay*, 115 N.C. 38, 20 S.E. 173 (1894).

**When Assignment of Security Taken.**—If an assignment of the security is taken, the surety may have his redress upon it immediately in the name of the creditor but while it is not in force, the surety can not maintain an action for the money paid for the assignment. *Hodges v. Armstrong*, 14 N.C. 253 (1831).

**When Person Charged with Notice of Assignment.**—Where a judgment against a principal and the sureties on a note is paid by the sureties, and an assignment thereof is made to a trustee for the benefit of the sureties, but by a mistake payment is entered on the judgment record, which is afterwards corrected by the entry thereon of the assignment, a person taking a mortgage on the property of the judgment debtor, after the assignment is entered on the record, takes with notice of the assignment. *Patton v. Cooper*, 132 N.C. 791, 44 S.E. 676 (1903).

**§ 26-3.1. Surety's recovery on obligation paid; no assignment necessary.**—(a) A surety who has paid his principal's note, bill, bond or other written obligation, may either sue his principal for reimbursement or sue his principal on the instrument and may maintain any action or avail himself of any remedy which the creditor himself might have had against the principal debtor. No assignment of the obligation to the surety or to a third-party trustee for the surety's benefit shall be required.

(b) The word "surety" as used herein includes a guarantor, accommodation maker, accommodation indorser, or other person who undertakes liability for the written obligation of another. (1959, c. 1120.)

**§ 26-4. Subrogation of surety paying debt of deceased principal.**—Whenever a surety, or his representative, shall pay the debt of his deceased principal, the claim thus accruing shall have such priority in the administration of the assets of the principal as had the debt before its payment. (1829, c. 23; R. C., c. 110, s. 4; Code, s. 2096; Rev., s. 2843; C. S., s. 3964.)

**Scope.**—This section which confers on the claim of a surety, paying the debt for which he is surety, the dignity, in the administration of the assets of the principal, which the debt, if unpaid would have had, applies to a judgment whether the payment be made before or after the death of the principal. *Drake v. Coltrane*, 44 N.C. 300 (1853).

**When Co-Surety Deemed Bond Creditor.**—A co-surety, who pays the bond debt for which the other surety is equally bound, shall be deemed a bond creditor in

the administration of the estate of the deceased co-surety, under the act of 1828 as construed in *Drake v. Coltrane*, 44 N.C. 300 (1853); *Howell v. Reams*, 73 N.C. 391 (1875).

When a plaintiff, a co-surety, discharged the bond debt, for the payment of which the defendant's intestate was equally bound, he becomes a bond creditor as to the assets of the intestate; and when, pending an action for contribution, the administrator paid off the bonds voluntarily, of equal dignity with said surety debt,

having previously paid an open account, he committed a devastavit to the extent of the plaintiff's claim for contribution, such claim being for a sum smaller than the bonds so preferred and the open account. *Howell v. Reams*, 73 N.C. 391 (1875).

Applied, in subrogating widow to rights

of mortgagee where policy in which she is named beneficiary is assigned to and paid to mortgagee, in *Russel v. Owen*, 203 N.C. 262, 165 S.E. 687 (1932).

Cited in *Brown v. McLean*, 217 N.C. 555, 8 S.E.2d 807 (1940).

§ 26-5. **Contribution among sureties.** — Where there are two or more sureties for the performance of a contract, and one or more of them may have been compelled to perform and satisfy the same, or any part thereof, such surety may have and maintain an action against every other surety for a just and ratable proportion of the same which may have been paid as aforesaid, whether of principal, interest or cost. (1807, c. 722, P. R.; R. C., c. 110, s. 2; Code, s. 2094; Rev., s. 2844; C. S., s. 3965; 1957, c. 981.)

I. The Right to Contribution Generally.

II. When Surety Obtains Advantage over Co-Sureties.

III. Contribution Enforced.

A. In General.

B. Actions and Incidents Thereto.

## I. THE RIGHT TO CONTRIBUTION GENERALLY.

**Editor's Note.**—*Atwater v. Farthing*, 118 N.C. 388, 24 S.E. 736 (1896), was a case where A endorsed a note for the maker, and subsequently, but before it was discounted, F endorsed it. The principal became insolvent and left the State. A paid the note. The court held that F was a co-surety, and that the doctrine of contribution was applicable for A's benefit. The court said that the decision was governed by *Daniel v. McRae*, 9 N.C. 590 (1823) and *Dawson v. Pettway*, 20 N.C. 531 (1839).

**Rule of Contribution.**—The rule of contribution is founded upon the maxim that "equality is equity," and not upon contract. It is a rule of common justice whereby parties who undertake to account for the default or miscarriage of another, should equally bear the burden imposed by a failure of their principal. As between them, there is no agreement implied, but an equitable presumption raised by the fact of the payment by one, that the others will equalize the burden thus borne by him, by paying to him such sum as will make the loss equal upon each, which can be rebutted by showing that there was an agreement, whether verbal or written, to the contrary. *Smith v. Carr*, 128 N.C. 150, 38 S.E. 732 (1901). See *Allen v. Wood*, 38 N.C. 386 (1844).

This maxim can only be applied to those whose situations are equal; otherwise equality is not equity, and hence if one surety stipulates for a separate indemnity, the equality of situation between him and

his co-surety ceases, and the maxim does not apply. *Moore v. Moore*, 11 N.C. 358 (1826).

It is broadly stated in 2 *Brandt Suretyship* 309, that "A surety who pays his principal's debt is entitled to be subrogated to all the rights and remedies of the creditor against his co-surety in the same manner as against the principal." This is founded in reason and justice, and up to the adoption of our present Constitution was enforced in the courts of equity. Article IV, § 1, of the Constitution abolished the distinction between actions at law and suits in equity, leaving such rights and remedies to be enforced in the one court, which theretofore had administered simply legal rights. *Peebles v. Gay*, 115 N.C. 38, 20 S.E. 173 (1894).

The liability of sureties among themselves is controlled by the equitable principle of equality arising out of a common risk, and in case of insolvency or nonresidence these rights are adjusted by reference to the number of sureties who are solvent or who have property available to process within the jurisdiction of the court. *Fowle v. McLean*, 168 N.C. 537, 84 S.E. 852 (1915).

**Same — Primary and Conditional Liability.**—The equitable doctrine of contribution is enforced upon the principle that those engaged in a common hazard in the same degree or relation should bear the loss equally, but where one is surety and the others endorers, the liability of the former is primary and of the latter a conditional one, and not being in the same situation with regard to the hazard, the surety is not entitled to contribution from the endorers. *Edwards v. Jefferson Standard Life Ins. Co.*, 173 N.C. 614, 92 S.E. 695 (1917).

**Presumption of Equity.** — Co-principals and co-sureties are presumed to assume equal liability, but this presumption may



be rebutted by parol evidence. *Smith v. Carr*, 128 N.C. 150, 38 S.E. 732 (1901).

**Surety for Other Sureties.**—It is entirely competent for one person to become surety for other sureties, or to limit the extent of his liability with respect to other sureties. The test of liability is the intent of the parties as indicated by their agreement. *Citizens Nat'l Bank v. Burch*, 145 N.C. 316, 59 S.E. 71 (1907).

**Sureties on Successive Guardianship Bonds.**—The sureties to the successive bonds of a guardian stand in the relation of co-sureties, one bond to the other or others, and are liable, in case of insolvency of the guardian, to contribution in proportion to the amount of the several penalties of the bonds. The risk they take is a joint risk, and there is an implied engagement or obligation, each set of sureties with the other, to bear any loss which may fall on them proportionally, as above stated; or, if it is borne by one class, to contribute by way of reimbursement. *Bell v. Jasper*, 37 N.C. 597 (1843); *Jones v. Hays*, 38 N.C. 502 (1845); *Bright v. Lennon*, 83 N.C. 184 (1880).

Where a guardian gives several successive bonds for the faithful discharge of his trust, the sureties on each bond stand in the relation of co-sureties to the sureties on every other bond; the only qualification to the rule being that the sureties are bound to contribution only according to the amount of the penalty of the bond in which each class is bound. *Jones v. Hays*, 38 N.C. 502 (1845).

All the bonds given by a guardian are but securities for the same thing, and the sureties on each are bound to contribution, but their liabilities are in proportion to the amount of their respective bonds. *Jones v. Blanton*, 41 N.C. 115 (1848).

**When Surety Should Answer for Default and Stop Costs.**—As a general rule, upon the default and insolvency of a principal, a surety should answer for the default, and not unnecessarily let cost be run up where the liability and amount thereof is clear. But where, as in the instant case, the guardian claimed to have settled with and paid the wards, it was prudent in plaintiff in regard to his own interests and as an act of justice to his co-sureties on other bonds, to incur costs to the point of developing how the fact of alleged settlement was, and to this effect are the authorities. *Bright v. Lennon*, 83 N.C. 184 (1880).

The costs incurred by one surety, or one set of sureties, are not always to be regarded as a loss borne to which in equity

contribution may be had, but it would seem to depend on the prudence and bona fides of the defense by which they were incurred. *Bright v. Lennon*, 83 N.C. 184 (1880).

**Assets Given Up by Mistake of Law.**—Where A and B were co-sureties on an administration bond, and being sued upon the same by one of the next of kin, and while the suit was pending compromised the same under the advice of counsel and from an honest belief that both were liable to a larger sum on account of the devastavit and insolvency of their principal, and it is afterwards discovered that B, who had administered on the estate of the principal, had, by a misapprehension of law, but acting under legal counsel, and in good faith, erroneously given up assets of their principal to another claim, which, if they had been held by him, would have saved them both from loss by this suretyship, yet it was held that A could not sustain a bill to throw the whole loss on B, there being no evidence that B had concealed from A the fact of having thus parted with the assets and not making any allegation of fraud or imposition on the part of B. *Brandon v. Medley*, 54 N.C. 313 (1854).

**Release of Principal.**—A surety who seeks to recover from a co-surety a ratable part of money paid must take care to do no act which will prevent the co-surety from having recourse against the principal. If, therefore, he release the principal, it is a discharge of the co-surety. *Draughan v. Bunting*, 31 N.C. 10 (1848).

**Sureties on Sheriff's Tax Bond.**—The right of contribution does not exist between sureties of the different bonds of a sheriff as tax collector. *McGuire v. Williams*, 123 N.C. 349, 31 S.E. 627 (1898).

**When One Surety In Fact Surety for Co-Surety.**—Where A. and B. signed a negotiable note apparently as joint principals, when, in fact, the latter was surety for the former and the appellant signed the note by writing his name across the back, with the word "surety" underneath, it was held that in the absence of any evidence that appellant knew of the relation between the makers, he was surety for the two, and that surety B. could not compel contribution. *Citizens Nat'l Bank v. Burch*, 145 N.C. 316, 59 S.E. 71 (1907).

**Release by Securing Part of Debt.**—If there be several sureties for the same principal, and one of them be fixed with the payment of the whole debt, or of more than his ratable part thereof, the others, who are solvent, shall be compelled to

contribute, in order to equalize the loss. But if by any agreement between the sureties, one of them is released by the creditor, upon his securing the payment of a certain part of the debt, he shall not afterwards be called upon to contribute to one or more of the remaining sureties, for a loss arising from the deficiency of another to them. *Moore v. Isley*, 22 N.C. 372 (1839).

**Agreement between Sureties.** — There can be no doubt that after two persons have become sureties for a common principal they may, by agreement between themselves, renounce their right to take benefit from any securities they may respectively obtain, and each look out for himself exclusively for an indemnity from the principal or for contribution from another co-surety. *Long v. Barnett*, 38 N.C. 631 (1845); *Commissioners McDowell County v. Nichols*, 131 N.C. 501, 42 S.E. 938 (1902).

Where the land of one of two sureties of a third person was sold under execution for the debt, and the other surety and a third person bid it off, it was held that an agreement by the surety who owned the land to take the whole debt upon himself and satisfy the execution in return for an assignment of the bid to him, was a promise to pay his own debt and not affected by the statute of frauds; and in such case the surety who paid could not obtain contribution from his co-surety. *Hockaday v. Parker*, 53 N.C. 16 (1860).

## II. WHEN SURETY OBTAINS ADVANTAGE OVER CO-SURETIES.

**Property Advanced by Principal to One of Sureties.** — Where money is advanced by the principal to one of the sureties, to discharge the debt, before the debt is actually discharged, the co-surety may file his bill in equity for an account and for relief but if the money is paid by the principal after the debt has been discharged by the sureties, to one of two sureties, to reimburse both, then the co-surety has his remedy against the surety receiving the money, by an action at law for money had and received, and, therefore, cannot support a suit in equity. *Allen v. Wood*, 38 N.C. 386 (1841).

An indemnity obtained from a principal by one of two co-sureties, after the risk is incurred, inures equally to the benefit of both. *Pool v. Williams*, 30 N.C. 286 (1848).

Where the principal placed property in the hands of a surety sufficient to satisfy the debt, and then left the State, it was

held that a third person, also bound for the debt as surety, having been compelled to pay it, might recover its amount from the person who had received the property without making a previous demand. *Parham v. Green*, 64 N.C. 436 (1870), citing *Sherrod v. Woodward*, 15 N.C. 360 (1833); *Hall v. Robinson*, 30 N.C. 56 (1847); *Draughan v. Bunting*, 31 N.C. 10 (1848); *Norfleet v. Cromwell*, 64 N.C. 1 (1870).

When two persons engage in a common risk as sureties for a third and one of them subsequently takes an indemnity from the principal debtor it inures to the benefit of both. *Fagan v. Jacocks*, 15 N.C. 263 (1833); *Gregory v. Murrell*, 37 N.C. 233 (1842); *Hall v. Robinson*, 30 N.C. 56 (1847).

**Separate Indemnity.** — In *Long v. Barnett*, 38 N.C. 631 (1845), the court said: "As one, when he is about to become a surety with others, may stipulate for a separate indemnity from the principal to him, and the co-sureties would be only entitled to a surplus after his reimbursement. *Moore v. Moore*, 11 N.C. 358, 15 Am. Dec. 523 (1826)." *Commissioners of McDowell County v. Nichols*, 131 N.C. 501, 42 S.E. 938 (1902).

**When Indemnity May Be Reached.** — The indemnity taken by one surety can be reached by the other only in two cases, either when it was taken in fraud, or for the benefit of the other. *Moore v. Moore*, 11 N.C. 358 (1826).

**Before and after Severance of Relationship.** — While the relation of joint sureties exists, funds received by one of them (except under special circumstances) for the discharge of, or as an indemnity against, his liability, are to be applied for the common benefit of the sureties. But after that connection has been severed by an agreement among the sureties, each of them has his distinct and several claim to prosecute, because of what he has paid for his principal, or for an insolvent joint surety; and the others have no right to demand participation in what his diligence may enable him to procure, while thus prosecuting his several claims. *Moore v. Isley*, 22 N.C. 372 (1839).

**When Advantage Lost by Laches.** — Where the surety merely had a deed of trust for certain property, as an indemnity, executed by the principal, and neglected to have it registered, so that the property was sold by other creditors, the co-surety is not entitled, on account of this laches, to make him responsible for the value of the property. *Pool v. Williams*, 30 N.C. 286 (1848).

**Supplementary Surety.** — Where one of two sureties claims to be a supplemental surety by agreement, the burden is upon him to show the agreement. *Carr v. Smith*, 129 N.C. 232, 39 S.E. 831 (1901).

**Parties.** — One of three joint solvent sureties cannot sustain a bill against either of his co-sureties for contribution out of a fund alleged to have been received by that surety for his indemnity from the estate of an insolvent co-surety, without making the other a party. *Moore v. Isley*, 22 N.C. 372 (1839).

### III. CONTRIBUTION ENFORCED.

#### A. In General.

**Accommodation Maker and Endorser.** — An accommodation maker who pays a note may recover contribution from an accommodation endorser of the note where they intended to become co-sureties. *Gilliam v. Walker*, 189 N.C. 189, 126 S.E. 424 (1925).

**Co-Surety Paying Bond Debt Deemed Bond Creditor.** — In *Howell v. Reams*, 73 N.C. 391 (1875), it was held that a co-surety who pays the bond debt, for which the other surety is equally bound, shall be deemed a bond creditor in the administration of the estate of the deceased co-surety. *Peebles v. Gay*, 115 N.C. 38, 20 S.E. 173 (1894).

**Liable for Ratable Part of Debt Only.** — The section provides that where one or more sureties have been compelled to satisfy the contract of their principal, they may sue their co-sureties for their ratable part of the debt paid for the principal. *Peebles v. Gay*, 115 N.C. 38, 20 S.E. 173 (1894).

There was a judgment against the principal and two sureties, and an execution levied on the property of one of the sureties. A bought this property from this surety, pending the levy, and afterwards obtained an assignment of the judgment to enable him to have the whole amount satisfied out of the property of the co-surety, and issued an execution for that purpose. It was held that he was restrained from collecting out of the co-surety more than the fair proportion which the latter owed, whether A had actual notice of the lien of the execution or not. *Dobson v. Prather*, 41 N.C. 31 (1849).

**Rights of Surety Paying Entire Debt.** — Under the act of 1807, now this section, one surety may recover at law from another his ratable proportion of the debt of the principal, but the rights of the surety who pays the debt are not enlarged nor is the co-surety deprived of any just

grounds of defense which would before have been available to him in equity. *Hall v. Robinson*, 30 N.C. 56 (1847).

A surety who, pursuant to his contractual obligation, pays the debt of his principal has a right of action to recover the sum so paid. *American Nat'l Fire Ins. Co. v. Gibbs*, 260 N.C. 681, 133 S.E.2d 669 (1963).

This section affords a right to one surety, who has paid a debt for which he and another are equally liable, to call on the other for contribution. *American Nat'l Fire Ins. Co. v. Gibbs*, 260 N.C. 681, 133 S.E.2d 669 (1963).

**In Case of Absent Co-Surety.** — A co-surety must make contribution, without regard to the share of contribution, which the absent co-surety would have had to pay, had he been within the reach of the process of North Carolina courts. *Jones v. Blanton*, 41 N.C. 115 (1848).

**Accommodation Endorser Not Liable as Co-Surety.** — Where A, as surety, signed the note of B, payable to C, and it was endorsed by C, at the request and for the accommodation of B, there being no contract between A and C whereby they agree to become co-sureties of B, it was held that A had no right to contribution from C. *Smith v. Smith*, 16 N.C. 173 (1828).

**Liability Need Not Be Fixed by Judgment.** — It is not necessary, to entitle a surety to maintain an action for contribution, that the amount of his liability which was paid by him should be fixed by a judgment. *Bright v. Lennon*, 83 N.C. 184 (1880).

**Statute of Limitations.** — In the case of a surety's payment and action for contribution against the co-surety, the statute of limitations runs only from the payment. *Sherrod v. Woodward*, 15 N.C. 360 (1833); *Craven v. Freeman*, 82 N.C. 361 (1880).

A surety who pays money for his principal may maintain an action against his co-surety for his ratable part, without first making a demand, and the statute of limitations, therefore, begins to run from the time of the payment of the money. *Sherrod v. Woodward*, 15 N.C. 360 (1833).

**Same—Failure to Plead.** — A surety when sued is not bound to plead the statute of limitations, but may or may not according to his discretion. *Jones v. Blanton*, 41 N.C. 115 (1848); *Street v. Board of Commissioners*, 70 N.C. 644 (1874); *Craven v. Freeman*, 82 N.C. 361 (1880). And if so, the withdrawal of such a plea or a waiver of it ought not to affect and does not affect the right to con-



tribution. The design of that plea is to protect against a false and unjust claim or one of whose discharge the evidence is lost, but it is not obligatory in morals or law to use it to defeat a just debt. *Bright v. Lennon*, 83 N.C. 184 (1880).

A surety to a guardian bond, when sued by the wards, is not bound to avail himself of the statute of limitations and a failure to do so does not release co-sureties. *Jones v. Blanton*, 41 N.C. 115 (1848).

#### B. Actions and Incidents Thereto.

A surety's right of action accrues at the time of payment, not before. *American Nat'l Fire Ins. Co. v. Gibbs*, 260 N.C. 681, 133 S.E.2d 669 (1963).

**Action at Law for Aliquot Parts.** — An action at law by surety for contribution lies only against the co-sureties, severally, for the aliquot part due from each. *Adams v. Hayes*, 120 N.C. 383, 27 S.E. 47 (1897).

Where two sureties on a note to a bank agreed, after the insolvency of their principal, to employ a broker to buy notes of the bank to an amount sufficient to pay the debt, and one of them paid the broker for notes purchased by him, and discharged the debt, it was held that he could maintain an action on the case against his co-surety for contribution. *DeRossett v. Bradley*, 63 N.C. 17 (1868).

**Surety Should Allege Principal's Insolvency.** — When one surety brings a bill for contribution against a co-surety, he should at least allege that the principal is insolvent, so that he can have no redress against him; for the equity of a plaintiff, seeking contribution from a co-surety, lies in the insolvency of the principal. *Allen v. Wood*, 38 N.C. 386 (1844).

A surety has no right to call upon his co-surety in equity for contribution, without showing that he could not obtain satisfaction for the amount he has paid from their common principal. *Rainey v. Yarborough*, 37 N.C. 249 (1842).

**When Insolvency Not Alleged and Improper Relief Asked.** — Where a complaint in an action by a surety for contribution, joined the principals as parties, and alleged the contract of suretyship, payment by the plaintiff and demand of the co-sureties "for their contributive shares," and asked judgment against all, but did not allege insolvency of the principal except by the averment that plaintiff was compelled to pay the debt, it was held that, though the proper relief was not asked, and the insolvency of the principals was imperfectly alleged, the cause of action will be construed, on demurrer, as equi-

table rather than legal, in order to confer jurisdiction below. *Adams v. Hayes*, 120 N.C. 383, 27 S.E. 47 (1897).

**Costs Paid by Plaintiff.** — In an action by a surety of an insolvent guardian for contribution against other sureties, it is proper to include in the sum adjudged to be raised by contribution costs which were paid by plaintiff in an action against him as a condition for leave to plead the statute of limitations. *Bright v. Lennon*, 83 N.C. 184 (1880).

**When Surety Must Show Actual Money Payment.** — Where a surety brings an action of assumpsit, for money paid for the use and at the request of the defendant, against his co-surety, to obtain contribution, it is not sufficient for him to show that he has given his note for the debt due by the principal, and that the same has been accepted by the creditor as a payment and discharge of the debt. To entitle him to recover in this action, he must prove an actual payment in money, or in money's worth, such as bank notes, the note of a third person, or a horse or the like, which is valuable in itself to the surety who parts with it. *Brisendine v. Martin*, 23 N.C. 286 (1840).

**Notice.** — In an action for contribution by a surety against four different guardian bonds, with different penalties and different sureties, some solvent and some otherwise, it is not necessary that notice should be given before the action is brought. *Bright v. Lennon*, 83 N.C. 184 (1880).

**Right to Demand Waived.** — Where the plaintiff brings suit for contribution against a co-surety on a note, alleging his liability as such, and that he had failed or refused reimbursement to the extent of his liability to the plaintiff, who had paid the same, and the defendant answers, denying liability, and there is no averment that demand had been previously made on the defendant, the right to a demand is waived by the answer, and the statement of the cause of action, being only defective, is cured. *Shuford v. Cook*, 164 N.C. 46, 80 S.E. 61 (1913).

**What Co-Sureties Must Be Made Parties.** — A surety, who has been compelled to pay the debt of his principal, must make all his co-sureties parties to a bill for contribution, if they are in this State and solvent. But where one is out of the jurisdiction of the court, and others are within it, the plaintiff, by stating the fact in his bill, is at liberty to proceed against the latter alone. *Jones v. Blanton*, 41 N.C. 115 (1848).

**Principal or Executor Party Defendant.**

—To a bill brought by one surety against his co-surety for contribution, their common principal, or, if he be dead, his executor or administrator should be made a party defendant. *Rainey v. Yarborough*, 37 N.C. 249 (1842).

**Bankruptcy of Principal.**—Where it appears that the principal on a note has secured his discharge in bankruptcy from his obligations, including a note paid at maturity by one of two sureties thereon, and that a few months thereafter the surety who paid the note brought his action for contribution against his co-surety, who has paid nothing, the right of action given by Revisal, § 2844, now this section, will not, without more, be denied upon the ground that it requires the insolvency of the principal, in such cases, to be shown at the institution of the action. *Shuford v. Cook*, 164 N.C. 46, 80 S.E. 61 (1913).

**Interest on Collaterals.**—In an action against an alleged co-surety to recover money paid in settlement of their joint liability, the amount received by the plaintiff as interest on collaterals deposited, should be deducted from the amount paid by plaintiff. *Carr v. Smith*, 129 N.C. 232, 39 S.E. 831 (1901).

**Discharge of Levy by Co-Surety.**—A, having a judgment against B, as principal, and C, as surety, C, without the con-

sent of A, has an execution issued and levied upon B's property. A, has a right to withdraw the execution and discharge the levy, without making herself liable to C. *Forbes v. Smith*, 40 N.C. 369 (1848).

**Principal's Reputation to Show Insolvency.**—In an action for contribution by a surety against his co-surety, the plaintiff may offer evidence of their principal's insolvency by showing his general reputation, and this even after direct evidence of the said principal's insolvency. *Leak v. Covington*, 99 N.C. 559, 6 S.E. 241 (1888).

**Record of Judgment in Evidence.**—A surety seeking contribution from a co-surety can offer in evidence the record of a judgment against the surety as such, which, in the absence of any suggestion of fraud or collusion in procuring the same, is prima facie proof of the damages suffered by the said surety. *Leak v. Covington*, 99 N.C. 559, 6 S.E. 241 (1888).

**Operation of Parol Evidence Rule.**—The rule that parol evidence cannot be admitted to contradict a written contract, applies to actions on the contract itself, but not to such as arise collaterally out of it. So, where it appeared on the face of a note that certain parties thereto were sureties, in an action for contribution, parol evidence is admissible to show that they were really principals. *Williams v. Glenn*, 92 N.C. 253 (1885).

**§ 26-6. Dissenting surety not liable to surety on stay of execution.**

—Whenever any judgment shall be obtained before a justice against a principal and his surety, and the principal debtor shall desire to stay the execution thereon, but the surety is unwilling that such stay shall be had, the surety may cause his dissent thereto to be entered by the justice, which shall absolve him from all liability to the surety who may stay the same. And the constable or other officer, who may have the collection of the debt, shall make the money out of the property of the principal debtor, and that of the surety for the stay of execution, if he can, before he shall sell the property of the surety before judgment. (1829, c. 6, ss. 1, 2; R. C., c. 110, s. 3; Code, s. 2095; Rev., s. 2845; C. S., s. 3966.)

**§ 26-7. Surety, indorser, or guarantor may notify creditor to take action.**—(a) After any note, bill, bond, or other obligation becomes due and payable, any surety, indorser, or guarantor thereof may give written notice to the holder or owner of the obligation requiring him to use all reasonable diligence to recover against the principal and to proceed to realize upon any securities which he holds for the obligation.

(b) The surety, indorser or guarantor who gives notice to the holder or owner of the obligation as provided by subsection (a) shall forthwith give written notice to all co-sureties, co-indorsers and co-guarantors of the fact that such notice is being given to the holder or owner of the obligation, and such co-sureties, co-indorsers and co-guarantors shall have ten days after receipt of the notice in which themselves to give written notice to the holder or owner of the obligation and to their co-sureties, co-indorsers, and co-guarantors, that they join in or adopt the notice given pursuant to subsection (a). Failure of such surety, in-

dorser or guarantor to give the required notice to co-sureties, co-indorsers or co-guarantors whose names and residences are known to him or can be obtained by due diligence bars such surety indorser or guarantor from any of the benefits of G.S. 26-9.

(c) The holder or owner of the obligation shall on demand disclose to any surety, indorser, or guarantor of the obligation the names and addresses of all other sureties, indorsers and guarantors which appear on the obligation or of which he has knowledge.

(d) Nothing herein contained shall apply to official bonds, or bonds given by any person acting in a fiduciary capacity. (1868-9, c. 232, s. 1; Code, s. 2097; Rev., s. 2846; C. S., s. 3967; 1951, c. 763, s. 1.)

**Cross Reference.** — As to statute of limitations, see subdivisions 1 and 6 of § 1-52.

**Editor's Note.**—For brief comment on the 1951 amendment of this section and §§ 26-8 and 26-9, see 29 N.C.L. Rev. 413.

The cases cited below were decided prior to the 1951 amendment, which rewrote this section.

**Reasonable Compliance.** — The requirements of this section are reasonably complied with when the holder of a negotiable note, after receiving notice in accordance with this section, within thirty days causes the maker to be a party defendant, and it is made to appear that he is a non-resident. *Taylor v. Bridger*, 185 N.C. 85, 116 S.E. 94 (1923).

**Written Notice—Required.** — To have the benefit of the next preceding section and that there may be no controversy as to whether the demand is sufficient to have this effect, it must be a notice in writing given to the creditor; and its benefits are secured to such only as give the notice if there be more than one surety. *First Nat'l Bank v. Homesley*, 99 N.C. 531, 6 S.E. 797 (1888).

**Protection Secured.** — In *Moore v. Goodwin*, 109 N.C. 218, 13 S.E. 772 (1891), it was held that payment made by a principal upon a bond, before the cause of action thereon is barred against the sureties, arrests the operation of the statute of limitations.

This section affords relief to securities in cases not provided for in the preexisting law, by requiring the creditor, at the instance of the surety who considers himself in danger of loss from his contingent liability, to bring suit, and use reasonable diligence in making his money from the principal, and saving harmless the surety, at the hazard of losing his claim upon the latter, if negligent in doing so. But official bonds or securities held as collateral are excepted from the operation of this section; nor does it reach a case where the requirement of the sureties was verbal only, if in other aspects applicable to such

case. *First Nat'l Bank v. Homesley*, 99 N.C. 531, 6 S.E. 797 (1888).

Where an action was brought upon a negotiable instrument the defendants on its face being joint makers, the mere fact that the plaintiff had told one of the defendants, without the knowledge of the other, "that he would take up and carry the note until fall," was held to constitute an extension of payment for a "fixed and definite" period, which would operate as a release to such other from liability but his remedy is by quia timet notice under this section. *Roberson-Ruffin Co. v. Spain*, 173 N.C. 23, 91 S.E. 361 (1917).

**Same—Endorser in Blank of Nonnegotiable Paper.** — The rights of an endorser in blank upon a nonnegotiable note are sufficiently protected under the section which provides that a surety or endorser on any note, bill, bond or written obligation, except those held in trust or as collateral, may notify, in writing, the payee or holder, requiring him to bring suit and use all diligence to collect, and if the payee or holder refuses to bring action within thirty days, the surety or holder giving notice is discharged. *Johnson v. Lassiter*, 155 N.C. 47, 71 S.E. 23 (1911).

**Surety Released after Thirty Days.** — The surety can give the holder written notice quia timet to bring suit under this section, and if the holder does not do so within thirty days the surety will be released. *Cole v. Fox*, 83 N.C. 463 (1880); *Coffey v. Reinhardt*, 144 N.C. 509, 19 S.E. 370 (1907).

**Legal Duty of Principal.**—Except when required by written notice under this section it is not the legal duty of the principal to institute a suit against the debtor, or to pursue such a suit with diligence and to call to his aid all of the remedies provided by the law. *Bell v. Howerton*, 111 N.C. 69, 15 S.E. 891 (1892).

**When Inapplicable.**—Where there is an agreement in a negotiable note that the endorsers will continue to be bound notwithstanding an extension of time granted



to the maker, the endorsers cannot avail themselves of the provisions of this section, when the maker is a nonresident, demand for payment after dishonor has been made upon the resident endorsers, de-

fendants in the action, and they have delayed to give the statutory notice until after action commenced. *Taylor v. Bridger*, 185 N.C. 85, 116 S.E. 94 (1923).

**§ 26-8. Notice; how given; prima facie evidence thereof.**—(a) Any notice authorized or required to be given by G.S. 26-7 shall—

(1) Be served by the sheriff by delivering a copy thereof to the person entitled to the notice, or

(2) Be sent by the person giving notice, by registered mail, with return receipt requested, to the last known address of the person being notified.

(b) Upon serving the notice, the sheriff shall return the original thereof, with his return thereon, to the person who caused the notice to be given.

(c) The sheriff's return, when the notice is served by the sheriff, or the return receipt, when the notice is sent by registered mail, shall be prima facie evidence of the giving of the notice. (1868-9, c. 232, s. 3; Code, s. 2099; Rev., s. 2848; C. S., s. 3968; 1951, c. 763, s. 2.)

**§ 26-9. Effect of failure of creditor to take action.**—(a) If the holder or owner of the obligation refuses or fails, within 30 days from the service or receipt of such notice, to take appropriate action pursuant thereto, the following persons shall be discharged on any such note, bond, bill or other obligation to the extent that they are prejudiced thereby:

(1) The surety, indorser or guarantor giving such notice, and

(2) All co-sureties, co-indorsers or co-guarantors joining therein or adopting such notice as provided by G.S. 26-7, and

(3) All the co-sureties, co-indorsers, or co-guarantors whose names or addresses such holder or owner of the obligation failed to disclose on demand as required by subsection (c) of G.S. 26-7.

(b) The fact that an instrument contains a provision waiving any defense of any surety, indorser or guarantor by reason of the extension of the time for payment does not prevent the operation of this section. Any such notice to the holder or owner of the obligation as is authorized by G.S. 26-7 may be given at or subsequent to the time such obligation is due or at or subsequent to the termination of a period of extension.

(c) The failure of any co-surety, co-indorser or co-guarantor to join in or adopt a notice to the holder or owner of the obligation as authorized by subsection (b) of G.S. 26-7 does not prevent such co-surety, co-indorser or co-guarantor from giving a separate notice as authorized by subsection (a) of G.S. 26-7. (1868-9, c. 232, s. 2; Code, s. 2098; Rev., s. 2847; C. S., s. 3969; 1951, c. 763, s. 3.)

**Extension of Time.**—Where a creditor enters into a binding contract with his principal debtor for an extension of time, without consent of sureties, this ipso facto discharges them, and also any security given for the debt. *Hinton v. Greenleaf*, 113 N.C. 6, 18 S.E. 56 (1893); *Smith v. Building & Loan Ass'n*, 119 N.C. 257, 26 S.E. 40 (1896); *Jenkins v. Daniel*, 125 N.C. 161, 34 S.E. 239, 74 Am. St. Rep. 632 (1899); *Flemming v. Bordon*, 127 N.C. 214, 37 S.E. 219, 53 L.R.A. 316 (1900). Receipt of interest in advance is prima facie evidence of a binding contract of forbearance. *Hollingsworth v. Tomlinson*, 108 N.C. 245, 12 S.E. 989 (1891); *Scott v. Fisher*, 110 N.C. 311, 14 S.E. 799, 28 Am.

St. Rep. 688 (1892); *Smith v. Parker*, 131 N.C. 470, 42 S.E. 910 (1902).

Where a plaintiff creditor made a parol contract with principal to extend the time of payment of bond beyond the date of the commencement of a suit thereon, without the knowledge or consent of the surety, it was held that such contract has the effect of suspending the plaintiff's right of action and of exonerating the surety from liability. *Carrier v. Duncan*, 84 N.C. 676 (1881).

**Reservation of Right against Surety.**—An agreement with a principal on a sufficient consideration to forbear to sue for a fixed period, without reserving the right to proceed against the surety and made

without his assent, will exonerate him from liability. *Forbes v. Sheppard*, 98 N.C. 111, 3 S.E. 817 (1887).

agreement to forbear and is not affected by the creditor's breach of it. *Forbes v. Sheppard*, 98 N.C. 111, 3 S.E. 817 (1887).

The exoneration grows out of the

§ 26-10: Repealed by Session Laws 1943, c. 543.

§ 26-11. **Cancellation of judgment as to surety.**—Whenever a judgment shall be rendered in any court in accordance with the provisions of § 26-1 and the surety, endorser or other person shown in said judgment to be secondarily liable thereon and having the rights as by this chapter prescribed against the person or persons primarily liable, and the surety, endorser or other person so shown in the judgment to be secondarily liable, shall pay the said judgment or shall be compelled to pay an execution issued thereon and such fact shall appear to the satisfaction of the clerk of the superior court of the county in which the said judgment is rendered and docketed, such judgment shall be canceled as to said surety, endorser or other person secondarily liable and shall cease to be a lien upon his real estate and other property, but such cancellation shall not have the force and effect nor operate as a cancellation and discharge of the judgment as to any other person against whom the said judgment shall be rendered and the person so paying the said judgment shall have all the rights given to a surety who has been compelled to pay a judgment against the principal debtor and co-sureties which are given in this chapter, notwithstanding the cancellation of the said judgment as herein provided for. (1925, c. 38.)

§ 26-12. **Joinder of debtor by surety.** — (a) As used in this section, "surety" includes guarantors, accommodation makers, accommodation indorsers, or others who undertake liability on the obligation and for the accommodation of another.

(b) When any surety is sued by the holder of the obligation, the court, on motion of the surety may join the principal as an additional party defendant, provided the principal is found to be or can be made subject to the jurisdiction of the court. Upon such joinder the surety shall have all rights, defenses, counterclaims, and setoffs which would have been available to him if the principal and surety had been originally sued together. (1959, c. 1121.)

## Chapter 27.

### Warehouse Receipts.

#### Article 1.

##### General Provisions.

Sec.

27-1 to 27-4. [Repealed.]

#### Article 2.

##### Issue of Warehouse Receipts.

27-5 to 27-11. [Repealed.]

#### Article 3.

##### Obligations and Rights of Warehousemen on Receipts.

27-12 to 27-40. [Repealed.]

#### Article 4.

##### Negotiation and Transfer of Receipts.

Sec.

27-41 to 27-53. [Repealed.]

#### Article 5.

##### Criminal Offenses.

27-54. Issuing receipt for goods not stored.

27-55. Issuing receipt with false statement.

27-56. Issuing fraudulent duplicates.

27-57. Failure to state in receipt the interest of warehouseman.

27-58. Delivering goods without obtaining receipt.

27-59. Fraudulent deposit and negotiation.

#### Cross Reference.

For provisions of Uniform Commercial Code relating to warehouse receipts, bills of lading and other documents of title, see §§ 25-7-101 to 25-7-603.

#### ARTICLE 1.

##### *General Provisions.*

§§ 27-1 to 27-4: Repealed by Session Laws 1965, c. 700, s. 2, effective at midnight June 30, 1967.

#### ARTICLE 2.

##### *Issue of Warehouse Receipts.*

§§ 27-5 to 27-11: Repealed by Session Laws 1965, c. 700, s. 2, effective at midnight June 30, 1967.

#### ARTICLE 3.

##### *Obligations and Rights of Warehousemen on Receipts.*

§§ 27-12 to 27-40: Repealed by Session Laws 1965, c. 700, s. 2, effective at midnight June 30, 1967.

#### ARTICLE 4.

##### *Negotiation and Transfer of Receipts.*

§§ 27-41 to 27-53: Repealed by Session Laws 1965, c. 700, s. 2, effective at midnight June 30, 1967.

#### ARTICLE 5.

##### *Criminal Offenses.*

§ 27-54. Issuing receipt for goods not stored.—A warehouseman, or any officer, agent, or servant of a warehouseman, who issues or aids in issuing



a receipt knowing that the goods for which such receipt is issued have not been actually received by such warehouseman, or are not under his actual control at the time of issuing such receipt, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding five years or by a fine not exceeding five thousand dollars, or by both. (1917, c. 37, s. 50; C. S., s. 4090.)

§ 27-55. **Issuing receipt with false statement.**—A warehouseman, or any officer, agent, or servant of a warehouseman, who fraudulently issues or aids in fraudulently issuing a receipt for goods knowing that it contains any false statement, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding one year or by a fine not exceeding one thousand dollars, or by both. (1917, c. 37, s. 51; C. S., s. 4091.)

§ 27-56. **Issuing fraudulent duplicates.**—A warehouseman, or any officer, agent, or servant of a warehouseman, who issues or aids in issuing a duplicate or additional negotiable receipt for goods, knowing that a former negotiable receipt for the same goods or any part of them is outstanding and uncanceled, without plainly placing upon the face thereof the word “duplicate,” except in the case of a lost or destroyed receipt after proceedings for delivery as heretofore provided in this chapter, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding five years or by a fine not exceeding five thousand dollars, or by both. (1917, c. 37, s. 52; C. S., s. 4092.)

§ 27-57. **Failure to state in receipt the interest of warehouseman.**—Where there are deposited with or held by a warehouseman goods of which he is owner, either solely or jointly or in common with others, such warehouseman, or any of his officers, agents, or servants who, knowing this ownership, issues or aids in issuing a negotiable receipt for such goods which does not state such ownership, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding one year or by a fine not exceeding one thousand dollars, or by both. (1917, c. 37, s. 53; C. S., s. 4093.)

§ 27-58. **Delivering goods without obtaining receipt.**—A warehouseman, or any officer, agent, or servant of a warehouseman, who delivers goods out of the possession of such warehouseman, knowing that a negotiable receipt the negotiation of which would transfer the right to the possession of such goods is outstanding and uncanceled, without obtaining the possession of such receipt at or before the time of such delivery, except in the cases heretofore provided for in this chapter for the delivery of goods upon a lost receipt and for the sale of goods to satisfy the warehouseman's lien or because of their perishable or hazardous nature, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding one year or by a fine not exceeding one thousand dollars, or by both. (1917, c. 37, s. 54; C. S., s. 4094.)

**Cross Reference.**—As to punishment for unlawful disposition of property stored, see § 66-40.

§ 27-59. **Fraudulent deposit and negotiation.**—Any person who deposits goods to which he has not title, or upon which there is a lien or mortgage, and who takes for such goods a negotiable receipt which he afterwards negotiates for value with intent to deceive and without disclosing his want of title or the existence of the lien or mortgage, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding one year or by a fine not exceeding one thousand dollars, or by both. (1917, c. 37, s. 55; C. S., s. 4095.)

STATE OF NORTH CAROLINA

DEPARTMENT OF JUSTICE

Raleigh, North Carolina

*December 1, 1965*

I, Thomas Wade Bruton, Attorney General of North Carolina, do hereby certify that the foregoing recompileation of the General Statutes of North Carolina was prepared and published by The Michie Company under the supervision of the Division of Legislative Drafting and Codification of Statutes of the Department of Justice of the State of North Carolina.

THOMAS WADE BRUTON  
*Attorney General of North Carolina*

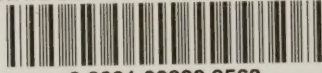








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